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Politics this week

Feb 20th 2003
From The Economist print edition

To the streets

Reuters

Millions of protesters against **war in Iraq** took part in scores of demonstrations around the globe—notably in Rome, London and Sydney. Both President George Bush and Tony Blair respectfully disagreed and began preparing a new resolution to submit to the United Nations Security Council.

See article: Does public opposition to the war matter?

Opponents of war also took heart from Hans Blix's most recent presentation to the UN. The chief **weapons inspector** said that Saddam Hussein's regime had become slightly more helpful, and he also cast doubt on some of America's claims that Iraq was hiding weapons from his inspectors. But he added that Iraq was still not complying fully, and time was running out.

See article: The United Nations and Iraq

European Union leaders agreed on a line toward Iraq: yes, give the inspectors more time, but no, that process could not be drawn out indefinitely. France went along with it. But Jacques Chirac told would-be EU members they were “not well brought up” to voice pro-American sentiments before they were inside the club—and hinted that France might call a referendum on their admission that would bar them.

See article: Europe's disarray over Iraq

The row in NATO over planning for **Turkey's** defence was sorted out, in a committee that does not include France, one of the two big objectors. But Turkey's government did not, as previously planned, put to its parliament a motion to admit American combat troops: it still wants a bigger compensation package, and written assurances against possible future independence for Kurds in northern Iraq.

See article: Caught in the crossfire

Terror on trial

The first person to stand trial for the **September 11th** terrorist attacks, Mounir al-Motassadeq, was found guilty in a German court of being an accessory to murder. The Moroccan was also convicted of attempted murder, grievous bodily harm and membership of a terrorist organisation. He was sentenced to 15 years in prison.

See article: One down, many more to go

Twenty-one people died in a stampede in a **Chicago** nightclub after security officers used pepper spray to break up a fight. Clubbers believed they were in a terrorist attack.

See article: Crushed in a nightclub

AP

The worst **snowstorms** for a decade killed more than 50 people in the north-eastern United States. The mayor of New York claimed that each inch of snow cost the city $1m.

See article: Blizzard

A new leader

Tasos Papadopoulos was elected president of the internationally recognised Greek part of **Cyprus**, beating 83-year-old Glafkos Clerides, who has held the job since 1993. The new man has taken a harder line over a settlement with the Turkish-Cypriots.

See article: Cyprus's new president

NATO-led peacekeepers in **Kosovo** arrested three ethnic-Albanian former guerrillas indicted by the UN's war-crimes tribunal in The Hague, the first ethnic Albanians to be nabbed on those grounds.

Over cries of anguish and “It'll never work” from media and motoring organisations, Europe's biggest city, **London**, brought in a £5 ($8) a day “congestion charge” on cars driving into the city centre. It (and the technology) did work: traffic was down by a third or so, and average speeds considerably up inside the zone.

See article: Avoiding gridlock

Dolly, a sheep famed as the first mammal to be cloned from an adult cell nucleus, was “put down” by her owner, the Roslin Institute in Scotland. She was suffering from lung disease.

Fighting, as usual

Fighting intensified in **Gaza**. After Hamas guerrillas blew up a tank with four Israeli soldiers inside, the Israeli army raided deep into Gaza City. Eight prominent Hamas militants were killed, as well as other Palestinian fighters and civilians. Rockets were shot over the border into Israel.

See article: Palestinian reform

Yasser Arafat said that he would be prepared to devolve power by appointing a prime minister if the Palestinian Authority's parliament, and the PLO's Central Council, agreed to change the draft constitution. The two bodies have been prevented by Israel from meeting.

See article: Hopes pinned on Palestinian reform

An **Iranian** military transport plane, with 302 people on board, crashed in south-east Iran, killing everyone.

In **Zambia**, after the supreme court turned down ex-President Frederick Chiluba's appeal against the removal of his immunity from prosecution, he was picked up by the police for questioning. His successor, Levy Mwanawasa, accuses him of corruption.

Robert Mugabe arrived in Paris for a Franco-African summit, having won an exemption from an EU travel ban. A British gay activist, Peter Tatchell, urged the French police to arrest the Zimbabwean president on torture charges.

See article: Zimbabwe's split politics

The battle against taxes

Further serious rioting in **Bolivia's** capital, La Paz, caused 27 deaths and forced the government of President Gonzalo Sánchez de Lozada to abandon its plans to raise taxes in order to secure new loans from the IMF.

See article: Behind Bolivia's violence

After long delays, **Peru's** former spy chief, Vladimiro Montesinos, at last went on public trial on 57 corruption charges.

See article: Montesinos goes on trial at last

War of words

In the latest exchange in its war of words with the United States, **North Korea** threatened to pull out of the armistice agreement that ended the Korean war in 1953. A North Korean plane briefly violated South Korean airspace.

See article: North Korea steps up its threats

The chief of **Pakistan's** air force and other senior officers were killed in a plane crash in the country's north-west. Bad weather was blamed.

Nearly 600 suspected drug dealers have been killed in the first three weeks of a “war on drugs” in **Thailand**, according to government figures.

See article: Drugs in Thailand

Two underground trains caught fire in the **South Korean** city of Daegu, killing at least 125 people. Police said a man with a history of mental illness had confessed to starting the fires.

AP

See article: South Korea's new president

Seven members of Abu Sayyaf, a Muslim terrorist group, were killed by Filipino soldiers on Jolo island, in the southern **Philippines**. Three soldiers died. American special forces are training Filipinos on the island.

In a move to stop the production of counterfeit copies of Hollywood movies in **Asia**, America's Motion Picture Association said it had allocated $150,000 to reward informants whose tip-offs lead to raids on pirate factories.

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Business this week

Feb 20th 2003
From The Economist print edition

Bad news day

Bad news from **Reuters**. The news and financial-information group reported a record pre-tax loss of £493m ($740m) in 2002, after losing £370m at Instinet, a part-owned American electronic stock exchange. Reuters' shares fell by 12% to a 14-year low, as the company announced that a further 3,000 jobs would go by 2005—some 20% of the workforce.

See article: Trouble at Reuters

Hugh Osmond, a British beer and pizza entrepreneur, was considering a bid for **Six Continents**, a British hotel and pub group planning a demerger. Mr Osmond hopes to pre-empt other bidders awaiting the split and grab the pub assets on the cheap.

See article: Reluctant dealmaking

America's trade deficit in goods and services widened to a record $44.2 billion in December, taking the total for 2002 to $435 billion. Producer prices rose by 1.6% in January, the biggest monthly increase for 13 years, thanks largely to a jump in energy prices.

Despite having a licence to print money, **De La Rue**, a British banknote-printer, issued its third profit warning in seven months. Public appetite for cash remains undimmed, but the business of providing machinery for handling and sorting cash ran into trouble.

Argos and **Littlewoods** were fined a record £23m ($37m) by British consumer watchdogs for fixing the price of toys made by Hasbro, including the boardgame Monopoly. The American toy firm, which also counts Cluedo among its products, escaped a fine by helping with the inquiries.

Glum Germans

German prosecutors charged six former top executives at **Mannesmann** over bonus and severance payments awarded after the mobile-phone company was taken over by Britain's Vodafone in 2000. Klaus Esser, a former chief executive, and other board members, including Josef Ackermann, chairman of Deutsche Bank's management board, were charged with “breach of trust”.

See article: German executives in the dock

Deutsche Bank was hit again after a German court ruled that Rolf Breuer, chairman of the bank's supervisory board, had breached client confidentiality by commenting on the financial state of Kirch, a now-insolvent media firm, on TV in 2002. The bank intends to appeal; compensation could run into many millions of euros.

See article: German banks

HVB, Germany's second-largest bank, lost *euro*926m ($925m) in the fourth quarter, taking losses for the year to *euro*858m. The bank blamed bad loans, weak stockmarkets and restructuring costs. It will not pay a dividend for 2002, a year in which its share price fell by 57%.

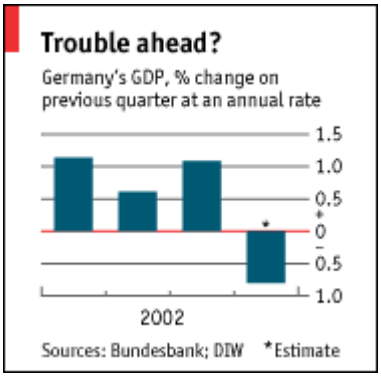
Volkswagen, Europe's largest carmaker, suffered a fall in pre-tax profits of 9.6% to *euro*4 billion ($3.8 billion) in 2002. The German firm suffered from weakening demand in America, where its ageing range

faced tough competition from newer models.

Didier Bellens quit as boss of RTL, **Bertelsmann's** broadcasting arm, as an unseemly spat erupted at the German media giant between its owners, the Mohn family, and executives. Reinhard Mohn said the vanity and greed of managers justified the family's option to block strategic decisions. Gerd Schulte-Hillen, Bertelsmann's chairman, told the family not to interfere.

A group of music companies is suing Bertelsmann for $17 billion over its investment in **Napster**, an online music firm. Napster has been driven out of business by copyright lawsuits, but the music companies claim that Bertelsmann's investment prolonged its life.

Germany's economy shrank by 0.8% in the fourth quarter compared with the previous quarter at an annual rate, according to preliminary estimates. If forecasts of a contraction in the first quarter of 2003 are correct, the euro area's biggest economy will have slipped into recession.



Switching phones

Microsoft's hopes of a grip on mobile telephony suffered a blow. **Samsung**, once courted by the software giant, joined the world's other four big phone makers by taking a 5% stake in **Symbian**, a rival to Microsoft in next-generation mobile-phone software.

America's **Wal-Mart**, the world's biggest retailer, enjoyed a 15.5% increase in fourth-quarter profits to $2.5 billion, helped by a useful performance at its foreign retailing businesses.

Swiss hard cheese

UBS made a loss of SFr101m ($68.7m) in the fourth quarter, after a big write-down of the value of PaineWebber, an American broker acquired by the Swiss bank in 2000, and a payment to settle charges of conflicts of interest brought by Eliot Spitzer, New York state's attorney-general.

Wachovia and **Prudential Financial** announced a long-expected tie-up of their brokerage businesses to create a company able to compete with America's big names in the industry.

Great-West Life, a Canadian insurance company, offered C$7.3 billion ($4.8 billion) for a rival, **Canada Life**. The merger will turn Great-West into Canada's biggest insurer, overtaking Sun Life of Canada.

See article: Canadian insurance

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Dealing with Saddam Hussein

Why war would be justified

Feb 20th 2003
From The Economist print edition

Saddam Hussein must be disarmed. If necessary, it should be done by force

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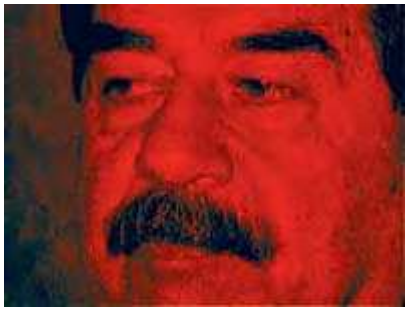

EMOTIONS are running high. The divisions seem deep, the language by turns bitter, arrogant and contemptuous, on all sides. Such descriptions apply both to the arguments between the more hawkish political leaders and the millions of people who marched in protest last weekend against the idea of war, in capitals around the world, and to those between the main governmental camps led by America and France. No doubt, the divide between the most extreme views on the various sides really is wide and unbridgeable. No doubt, too, the sight of such divisions brings comfort to the dictator in Baghdad. Yet there is plenty of cause to wonder just how comfortable he should really feel. For, studied more closely, the gap between the majority on both sides is looking bridgeable.

Start with the governments. The five veto-wielding permanent members of the United Nations Security Council—America, Britain, China, France and Russia—all voted last November for Resolution 1441, which demanded that Saddam Hussein should account for and relinquish all his biological, chemical and nuclear weapons programmes, or face “serious consequences”. As a result, the difference between Britain and America, on one side, and France, Russia and China, on the other, is not about that demand or the ultimate objective but about how much time Iraq should be given to comply with it. Even on timing, however, the latest difference over when a decision should be made seems to amount to a mere two weeks: America describes February 28th, the date of the next report to the Security Council by Hans Blix, the chief weapons inspector, as “a key day”. France prefers to point to March 14th, the date of his subsequent report. There may still be an argument then about whether Iraq is complying, and if not over the terms of a final demand to be made to Mr Hussein, but the month of inspections that will have taken place since the Franco-American split will provide scope for agreement.

Surely the marchers are more implacably divided from George Bush and Tony Blair? In terms of emotion and style, they are. But not in terms of substance. The marchers are against further violence or death but most are also firmly against the Iraqi dictator, who they realise is both violent and murderous. In most western countries, opinion polls show clearly that a majority would accept a war if it were authorised by the UN. Most marchers want Mr Hussein to give up his deadliest weapons, to abide by the 17 UN resolutions passed on Iraq since 1991, and to stop terrorising the 22m Iraqi people. If anything, they are even keener on “regime change” than the British and American governments, which for years have blown hot and cold over whether that is their aim. This makes these marches very different from those in the 1960s and early 1970s against the Vietnam war, when many protesters felt strong sympathy with the North Vietnamese and their leader, Ho Chi Minh. Unlike then, the disagreement is not one about objectives, nor, really, about the analysis of the problem. It is about whether a peaceful solution can still be found, as the marchers hope, or whether war is the only option.

That is the central ground on which the debate can and should take place. The issue of procedure—essentially, about who decides, the Security Council or America and Britain (see article)—is secondary to that basic question. Indeed, the issue of whether a peaceful solution can still be found will be the main determinant of whether a second resolution is eventually passed, whether after February 28th or March 14th.

A deadly sort of peace

If you agree that Saddam Hussein is a threat, as his Arab and Iranian neighbours do, then the choice between peace and war must begin with consideration of containment. In 1991, when the American-led, UN-authorised multinational force drove him out of Kuwait, it was decided that a ceasefire agreement was preferable to a full invasion of Iraq. The ceasefire resolution demanded disarmament of all chemical, biological, nuclear and long-range missile programmes within a year, a demand reinforced by economic sanctions. That containment regime was later buttressed with two “no-fly” zones policed by British and American aircraft. Weapons inspectors attempted to monitor compliance until 1998, after which they were excluded by Iraq until November 2002.

After 12 years, what has containment achieved? The inspectors found biological, chemical and nuclear programmes, but mainly when pointed to them by defectors. Meanwhile, this sort of peace has been extremely deadly: thousands of bombs have been dropped amid the policing of the “no-fly” zones and to prevent Mr Hussein from rebuilding his military facilities. The economic sanctions have been deadlier still. According to UNICEF, the UN children's agency, the poverty, squalor and poor health care associated with sanctions have been responsible for about 5,000 deaths a month of children below the age of five, in excess of the mortality rate before 1989. As that figure is derived by necessity from official Iraqi sources it may well be exaggerated. But even if the truth is half that number it would still mean that about 360,000 children had died as a result of 12 years of sanctions. The sanctions have been loosened—made smarter, in the jargon—but, combined with Mr Hussein's own acts and omissions, they still mean that many children are dying unnecessarily, every day. And that is without even mentioning Mr Hussein's political prisoners, his torture victims, the hundreds of thousands of Iraqis he has killed since he took power in 1978.

As *The Economist* has long argued, the sanctions are hurting Iraqis but not their dictator. Mr Hussein has maintained his tight grip on power, through brutal force, black-market revenues and his control of permitted oil earnings. The weapons inspectors' incomplete success during the 1990s was enough to confirm his ambition to use the deadliest weapons to extend his power. The overwhelming likelihood (confirmed by France's President Jacques Chirac in an interview this week in *Time*) is that he still possesses biological and chemical weapons, which he refused to disclose to the Security Council in December. So something has to change. The sanctions and continued bombing are unconscionable, and have anyway fed the anger felt towards America by many Muslims. But Mr Hussein still needs to be contained or disarmed.

The question is how. The normal diplomatic tools—sanctions, persuasion, pressure, UN resolutions—have all been tried, during 12 deadly but failed years. The sanctions need to go, urgently. But what to use in their place? Mr Hussein could be surrounded, to prevent him attacking others. But neighbouring countries are hardly keen on that, and it would only make him even more determined to develop weapons sufficiently powerful to be able to intimidate such a force. His country could be more or less occupied by a large UN security force, given the power to seize anything, go anywhere, stop any action it chooses, thus both bottling him up and enabling the inspectors to become the detectives they say they ought not to be. But when that was tried in Bosnia the force soon became hostages; and if the force were really large enough, he would surely resist it. Or he could be threatened with attack if he refuses to comply with Resolution 1441, according to deadlines set by the Security Council.

That last option is the one currently being pursued by the United States, through the UN. To *The Economist* it still looks the least bad of the limited range of available options; better, by far, than sticking to the failed and deadly policies of the past 12 years. Any military threat is risky and worrying. The United States has made this one even riskier by failing to make any progress in pressing Israel and Palestine to return to peace negotiations, and has made it sound more worrying by leaking vague but often contradictory plans for what arrangements might follow any war. Now, it would be wise to secure support for its threat through the UN, both to make the war less risky and to make the post-war peace more likely to be durable. But, in the end, the reality remains: if Mr Hussein refuses to disarm, it would be right to go to war. Saddamned, perhaps, if you do; but Saddamned, also, if you don't.

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Palestinian reform

Up and half-away, he goes

Feb 20th 2003
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Good news if Yasser Arafat appoints a prime minister; even better if Israel responds

Get article background

AP

THE Middle East's other black hole attracted a sideways look this week. Yasser Arafat took a step towards sharing his presidential power with a future prime minister, the Israelis allowed a Palestinian delegation to leave their besieged homeland and attend a meeting in London, and low-level diplomacy chugged softly on (see article). Just enough happening, it might be argued, to keep the Arab world reasonably calm while Iraq was being dealt with. Yet if the Israeli-Palestinian crisis is really to be cooled, let alone settled, it needs serious attention, and it needs it soon.

Even his best friends accept that Mr Arafat has become an obstacle to peace. Both Israel and America treat him as a non-person; the demand for Palestinian political "reform" has grown into a euphemism for the removal of the *rais*'s bottom from its long abode on what passes for a seat of power. The far-right allies of Israel's prime minister, Ariel Sharon, would like to boot Mr Arafat out of the country. They have been restrained, so far, by President George Bush, who can see the commotion this would cause in the Arab world.

So Mr Arafat's offer to kick himself upstairs is convenient. Reform of the Palestinian Authority (PA)—its politics, finances and security forces—is one of the demands of the "quartet", the group representing America, Russia, the European Union and the UN, that met with Palestinian and Israeli delegates in London this week. The first two varieties of reform are on their way. Political reform will be covered by constitutional changes turning the regime from a presidential to a prime-ministerial one: if routine decision-making escapes Mr Arafat's grasp, it will greatly contribute to the PA's efficiency. Financial reform is in the hands of Salam Fayyad, Mr Arafat's new finance minister, who has turned a steady beam of accountability on to murky money-bags. Security reform is the tricky one: Palestinian and Israeli security forces are unlikely to co-operate in keeping the peace until both governments are intent on trying to work things out by negotiation.

Will Mr Arafat's devolution of power advance that day? Only up to a point. For a start, the kick he has given himself is unlikely to be all that punishing; so long as he sticks around, his name and fame will be identified with the cause. No prime minister he appoints is likely to challenge the old man. Even more to the point, the chances of the proposed changes opening the way to peace depend on Israel having a government prepared to respond. That is, a government seriously inclined to make the territorial concessions that peace will eventually involve. So far Mr Sharon has seemed seriously disinclined even to enter into such negotiations.

Out of the cities, into talks

Mr Sharon says that he is not prepared to offer anything much towards carrying out the quartet's other directions—withdrawing his army from PA-controlled cities, easing the stifling restrictions imposed on civilians—until the Palestinians end all violence. That, by itself, is not an out-of-sight demand: Palestinian leaders, many of whom have come to recognise that the *intifada* plays into hardline Israeli hands, have been listening to an Egyptian proposal that the Palestinians declare a one-year unilateral ceasefire on military action. But, for this to work, there has to be the hope of peace at the end.

Moreover, Hamas, the strongest and most coherent of the Palestinian voices opposing PA policies, will agree only to a moratorium on attacks on civilians in Israel, and then only if it has a guarantee that Israel will stop assassinating its leaders. Israel scorns both the offer and its conditions: eight prominent Hamas men were killed in the past few days.

The result is stalemate, blood-stained for Palestinians and Israelis, and undesirable for the Bush administration. Plainly, the violence has to stop. But the Arab world, which is being drawn reluctantly into America's confrontation with Iraq, will be that much more unforgiving if America fails to draw a reluctant Mr Sharon towards negotiating a Palestinian peace.

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Europe's foreign policy

Uncommon disarray

Feb 20th 2003
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But Europeans should keep trying to co-operate where they can

IT HAS been one of the worst months imaginable for those who believe that Europe's assorted nations, from modest minnows to vainglorious machos, should be moulding a common foreign and defence policy that could match the clout of the world's greatest powers. Rarely, since the second world war, has Europe been in such disarray as it is now over Iraq. Yet it is still a desirable and not ridiculously Utopian aim that Europeans should, when possible, pool their minds, wallets and at times even perhaps their guns for the promotion of their own interests and the betterment of the world at large. There is no need for them to turn their backs on each other. Indeed, there is still a lot that they can do better together.

What makes the current row look so much worse than previous ones is that it comes at a time when the European Union has been grandiloquently striving for speedier and tighter integration across the board, including in foreign policy. The 15 countries already in the EU have been drawing up a new constitution that posits, among other things, a foreign minister for Europe answerable to its governments and a system of “qualified majority voting” even in foreign policy. The latest guess in Brussels, where a new Euro-constitution is being drafted at a special convention, is that these ideas may well be realised.

Yet imagine the chaos and bad blood that would ensue over an issue such as, well, Iraq. A too ambitious majority-vote system, with Europe divided slap down the middle, would be blown to smithereens. The Euro-optimists point out that issues touching on military matters, such as Iraq, will be exempt, and devices found to let pricklier countries who care passionately about particular issues, even non-military ones, opt out. Yet the line between military and other issues is invariably fuzzy (outsiders were first drawn into the recent Balkan wars on a humanitarian mission). The discord over Iraq shows how a supposedly joint policy, wrapped too tightly in an institutional straitjacket, can instead cause ever greater anguish and mistrust.

Still plenty to be getting on with

And yet there are useful lessons. Jacques Chirac, France's president, with his abusive language towards the countries likely to join the Union next year, has unwittingly illustrated how Europe's centre of gravity has shifted away from the old French-German alliance. Meanwhile, Europe is still doing a lot of collective work: most importantly, in the Balkans, where—be it noted—it failed dismally in the 1990s until America insisted on decisiveness; in world trade negotiations; in groping towards settlements between Israel and Palestine and on Cyprus; and in deploying the civilising “soft” power of aid-giving, nation-building and even peacekeeping, in regions far and near.

To build on all this, Europeans need to give more careful thought to where majority voting can usefully be applied. Then ways need to be found to ensure that, come next year, minnows like Malta or Latvia cannot stop the EU's other 23 countries acting together, but also that countries, especially the big ones with exceptionally strong interests in particular issues, cannot be steamrollered. Not common enough? The alternative, if not a bust-up, would be an endless search for the lowest common denominator, producing only the feeblest of policies. It is a fine thing to strive for unity where possible among Europeans in world affairs. It is quite another to expect it to exist everywhere—especially in a real crisis.

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Brazil

A time to talk, and a time to do

Feb 20th 2003
From The Economist print edition

He has promised the right things. Now Lula must get them done

Get article background

THE moderation looks lasting. Seven weeks into his presidency, Luiz Inácio Lula da Silva still seems a comfortable presence as leader of Brazil. Last year, during the election campaign, investors were so panicked by him that they took Latin America's biggest economy close to financial meltdown. When Mr da Silva accepted an accord with the IMF, they breathed again; and since he took office they have been cheered by a spending squeeze, to try to settle the country's finances, and two rises in interest rates, to help control inflation.

This week, in a break with tradition, Mr da Silva went in person to Congress to seek support for his economic reforms. These ambitious measures—reining in the burgeoning social-security deficit, rewriting the growth-stifling tax code, easing the job-killing labour laws and making the Central Bank independent—are the unfinished business of Fernando Henrique Cardoso, Mr da Silva's centre-right predecessor. As our survey in this issue reports, these reforms could propel Brazil towards first-world levels of prosperity and social justice. Without them, Brazil's economic performance will remain, at best, mediocre; at worst, it risks high inflation or a debt default.

There is a long way to go. It is one thing to announce a spending squeeze; it is another to resist, day in, day out, pressure from pork-hungry congressmen and cash-strapped state governors to relax it. Mr Cardoso just about managed to do so, despite a big majority in Congress. Mr da Silva, governing in a minority, has a tough act to follow.

Without reform in the public finances, as Mr da Silva is discovering, Brazil is not only forced to suffer sky-high interest rates but must crank out huge budget surpluses in order to service its debts. Since many of these debts are linked to the exchange rate or interest rates, any sudden loss of investor confidence can quickly turn to panic. Progress with reforms is thus not only desirable in itself, but will keep investors happy.

Seizing the moment

Mr da Silva's election was accompanied by a wave of optimism. The *real* rebounded and the “spreads” on Brazil's bonds—a measure of investors' wariness—plummeted. But in recent days, the currency has slipped and the risk premium has crept up again. Fears of war with Iraq have contributed to that, of course. But these market wobbles should remind Mr da Silva how little time he has before his honeymoon with Brazilians will end. He talks of seeking a national consensus on reforms. But most politicians now accept the need for them. Rather, the problem lies in the detail—and, above all, getting them into law. All too often, under Mr Cardoso, reforms announced with great fanfare were killed by legislative wrangling. So the sooner Mr da Silva's government comes up with its own blueprint and sends it to Congress, the better. If he delays, his golden opportunity to turn transient popularity into lasting change may be gone.

If he succeeds, the benefits will spread beyond Brazil. Many of its neighbours are in deep trouble. Argentina is bankrupt, and Uruguay teeters on the brink; Venezuela and now Bolivia are riven by conflict, while Colombia is assailed by drug-financed terrorism. The region desperately needs a positive example

of democratic continuity, combined with a broad agenda of social and economic reform, in which the poor can see hope of a better life ahead. If Lula is to embody that, it will not just be by speeches but in laws.

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South Korea

Sunshine or storms?

Feb 20th 2003
From The Economist print edition

The new president must not repeat his predecessor's naivety about the North

Reuters

Get article background

IT IS not, by any stretch of the imagination, the start he can have wanted. On February 25th, Roh Moo-hyun will be inaugurated as South Korea's president at what is starting to look like one of the bleaker moments in his country's history since 1953, when the Korean war ended. As if the appalling tragedy on an underground train in Daegu were not enough this week, North Korea threatened to terminate the armistice agreement with America that stopped the fighting 50 years ago.

Mere words? At the end of last year, North Korea pulled out of the Nuclear Non-Proliferation Treaty. It also expelled the weapons inspectors who were monitoring its plutonium-laden spent fuel rods and a reactor capable of producing more that can be reprocessed into fissile material for nuclear bombs. It is not yet clear whether the North has restarted the reactor, nor is much known about the secret uranium-enrichment programme that, last October, prompted the start of the present crisis. But North Korea may already have a couple of nuclear devices, and could quickly make more.

That uranium programme, above all, ought to weigh heavily on Mr Roh's mind as he takes the presidential oath. For it is the most obvious symbol of the failure of the doctrine for which his predecessor, Kim Dae-jung, will go down in history. His “sunshine policy” was premised on the belief that being friendly and generous towards North Korea would bring about its own reward in the shape of greater trust and lessened tension. Mr Kim received a Nobel Peace Prize in recognition of the policy's most glowing achievement, his summit meeting in 2000 with the North's Kim Jong Il. But in fact the North did little to reciprocate the warmth.

Promised family reunions have been few. Plans to reconnect the Koreas by train have bogged down. Ministerial meetings on a range of confidence-building measures have fizzled, though the northern Mr Kim kept his hand out for aid and other goodies. And it now emerges that the summit itself took place only following payment of a $186m sweetener to the North. That transaction, now under criminal investigation in South Korea, will dog Mr Roh's early days as president, since he and his predecessor are from the same party. And all the while, with its secret uranium project, North Korea was violating its agreements with both South Korea and America.

Learning the rules

Mr Roh's own politics are hard to read. In his younger days, he campaigned for the removal of American bases from South Korean soil, though he now says that was naive. During last year's election campaign, he endorsed the sunshine policy, but has since sounded distinctly frostier, saying that a nuclear-armed North Korea is unacceptable. All that suggests he is being rapidly acquainted with South Korea's realities. But it is still not at all clear that he has grasped the most important rule for dealing with the North: that America, South Korea and Japan, the three allies most closely involved in trying to wean it from its nuclear ambitions, all need to speak with a single voice if they are to have any hope of success.

The most useful thing Mr Roh can do is to make it clear that the flow of trade and investment, not to

mention large dollops of aid, will continue only if North Korea's nuclear programmes are dismantled. What is more, any deal would need to be a robust one that included, among other things, proper checks to ensure that it is honoured, as a 1994 agreement to freeze the North's plutonium production did not.

The right sort of deal with North Korea is essential to the success of Mr Roh's presidency. South Korea's economic recovery, after the Asian crisis that was in full flood when his predecessor was sworn in five years ago, is being undermined by uncertainty about the North. South Korea's bonds have been downgraded by ratings agencies and foreign investment is falling sharply. Having a nuclear-armed dictator threatening war from just across the border is not conducive to business confidence. Mr Roh needs to help do something about it.

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Letters

Feb 20th 2003
From The Economist print edition

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Stop the war

SIR – France and Germany insist that in opposing a war on Saddam Hussein they are motivated exclusively by a love of peace ("How deep is the rift", February 15th). However, their proposed solution, an indefinite continuation of the UN inspection process, can only work as long as America and Britain maintain an invasion force of 100,000 troops near Iraq. Nobody can doubt that once this force is withdrawn Saddam will simply kick out the inspectors, as he has done before. To prevent this, France and Germany should offer to cover the full cost of maintaining the troops for as long as it proves necessary. This would show that they are not simply motivated by anti-Americanism, cowardice and the self-interest of their politicians.

Andrzej Kozlowski
Yokohama, Japan

SIR – If France and Germany are so keen on a two-speed Europe, then why not a two-speed NATO? We will have 16 nations that are totally committed to mutual defence and some that we might help out if we feel like it.

Martin Turner
Hong Kong

Affordable luxury

SIR – You write that Pinault-Printemps-Redoute has suffered a "business catastrophe" in relation to its strategic move into the luxury-goods industry through its investment in Gucci ("A costly luxury", February 8th). This is a blatant misreading of the reality. PPR is in the process of focusing on its retail and luxury-goods activities. Our recent history shows that this shift has been a well-thought-out strategy. As part of this process, PPR will continue to exit other businesses in an orderly fashion and in very good conditions, as it has done recently.

Further, the acquisition of the current 58.2% shareholding in Gucci has been completed at prices that are below sector-average valuations. Funding details of this acquisition will be provided along with the full-year results on March 5th, but let me assure you that we expect PPR's financial structure to be strong at the end of 2004. Far from being a catastrophe, the recent developments of the group should provide the basis for stronger growth and results in the future.

Serge Weinberg
Chairman and CEO
Pinault-Printemps-Redoute
Paris

Watching, not doing

SIR – You state that Kinji Fukasaku's film "Battle Royale" could encourage teenage crime (Obituary, February 1st). The media may be a factor but more likely culprits include family and cultural breakdown, poverty, availability of firearms, and income inequality. Canadian teenagers watch much of the same stuff as American teens, yet commit far fewer crimes. Japanese youngsters have popular media awash

with sadistic violence, yet are strangely less violent than their American counterparts.

Henry Shieh
Woodside, New York

Christian message

SIR – When Lexington argues that President George Bush has “been careful to make his public speeches as ecumenical as possible”, he speaks a truth in a way that was probably not intended (February 8th). Ecumenicalism is specific to dialogue between Christian denominations; it is not a synonym for multi-religiosity. Mr Bush's speeches, especially since September 11th, have been undeniably Christian in nature. He is not speaking to a multi-religious nation but to his base in the fundamentalist Christian right.

Daniel Rothschild
Manchester

SIR – I suspect that secular Europeans, like secular Americans, have a distorted view of religion. The 20th century was the bloodiest in the history of humanity because of two world wars, the Korean and Vietnam wars, and the murderous regimes of Stalin, Hitler, Mao Zedong, Pol Pot, etc. The wars were started for secular causes; the mass murderers were atheists. One would think, after a century of overwhelming evidence proving the evil nature of secularism, that intelligent people would be less enthusiastic about it.

Roger McKinney
Tulsa, Oklahoma

Spain and the Basques

SIR – Your article on the Basque country could be misleading (“No truck with terrorism”, February 8th). The Spanish government indeed “wants to show that the region must become like any other part of Spain”. This does not mean that the Basque country's strong political, social and cultural personality should be diminished one iota. It just means that the basic right to live and vote freely, without the threat of terror, which anyone who happens not to be a nationalist has to suffer in that region, must be guaranteed. Only on February 8th, in a tragic example of this lack of normality, a member of the Socialist Party was killed in Andoain.

Marqués de Tamarón,
Spanish ambassador
London

Computer games

SIR – You are right that chess-playing ability says little about the potential of computers to mimic human intelligence (“Not so smart”, February 1st). However, you miss a broader point about recent progress in artificial intelligence. A more illuminating example can be found in backgammon. While chess programs have played at a world-class level for two decades, backgammon software based on the same brute-force approach has never achieved more than a weak intermediate level of play. The breakthrough came in 1995 with TD Gammon, a program based on a neural network that functions in a way very similar to the human brain.

Today, the best backgammon programs are arguably as good as the top human players and all are self-teaching systems based on neural networks. This has mirrored progress in fields as diverse as speech recognition and credit-card fraud detection, where modern techniques combined with a continuing explosion in computer power have made possible behaviour that seems very like human intelligence, albeit limited to a specific domain. Chess was never likely to be a good yardstick for measuring machine intelligence as its strictly formal nature, devoid of fuzziness and chance, is exactly the opposite of the kind of task where the human brain excels. The random element inherent in a dice roll makes backgammon a much better analogy for real-world mental problems.

Matthew Gertner
Prague

SIR – Fifty years ago everyone believed that playing chess required intelligence. Clearly we cannot trust our intuition about what can and cannot be achieved by mere number-crunching. Perhaps, 50 years from now, *The Economist* will be written by a computer?

George Moromisato
Cambridge, Massachusetts

SIR – The reason that people remain so much more impressive than computers is the sheer versatility of our intelligence, from feats of manual dexterity to the most abstract reasoning. Emo Philips, an American comedian, says it best: “A computer once beat me at chess but it was no match for me at kick boxing.”

Timo Hannay
London

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The United Nations and Iraq

Irrelevant, illegitimate or indispensable?

Feb 20th 2003
From The Economist print edition

AP

The UN risks a battering in the coming weeks. But don't write it off yet

AN ATMOSPHERE of misgiving pervades the upper storeys of the United Nations building in New York. Those who sit here, in the higher reaches of the Secretariat, fear that, come what may, the UN will emerge battered from the current struggle over Iraq. Some outside say it may not emerge at all.

Even before the latest, far-from-consensus-creating report from Hans Blix, the UN's chief weapons inspector, his masters were feeling the heat. Over and over, they had been hearing that this was a defining moment for the UN. “Iraq has now placed itself in danger of the serious consequences called for in UN Resolution 1441,” declared Colin Powell, America's secretary of state, before the UN Security Council on February 5th. “And this body places itself in danger of irrelevance if it allows Iraq to continue to defy its will without responding effectively and immediately.”

Some see something worse than irrelevance. “If the United Nations, having passed 1441, now refuses to authorise war,” argues George Will, a conservative American columnist, “the United Nations will essentially cease to exist. There is the outline of a satisfactory outcome: Saddam Hussein removed, the United Nations reduced.” Influential voices even closer to the Bush administration are already pondering how the UN might be remade when the time comes for a post-mortem on Iraq. Some openly question its current usefulness. “Is the [UN] better able to confer legitimacy than, say, a coalition of liberal democracies?” asks Richard Perle, a close adviser to the Bush administration. Others, scarcely bothering to disguise their glee, draw parallels with the League of Nations, the UN's ill-starred forebear. No wonder that, from the 38th floor of the UN building, some of the hawks ready to sweep down on Iraq seem more like buzzards who might relish a bit of carrion on their return.

Are things really so bad? Wouldn't a new resolution, following up 1441 and explicitly authorising war, put the critics to flight? Hardly. Cogent as the Americans' complaints may be, they are matched by equally cogent criticisms from non-Americans. The UN is, after all, meant to work for all its 191 members, not just the United States, even when it acts with the four other permanent members of the Security Council—Britain, China, France and Russia. If the Security Council gave America its authority to attack Iraq, the war would become legal, but for many, perhaps most people, it would still be illegitimate. In the opinion of huge numbers of Africans, Arabs, Asians and Latin Americans, and not a few Europeans too, the Security Council would simply be acting as an instrument of American foreign policy. Broadly speaking, the world does not take the view that Saddam Hussein is, at present, a threat to international peace and security—the only reason, apart from self-defence against an armed attack, that the UN

charter gives as a justification for war. If, in the absence of new evidence, the Security Council declared Iraq to be such a threat, many countries would see that as reflecting its subornation by the United States.

No worse than wurst

So what, it may be said? Most laws are forged of compromise, bribery and arm-twisting. That is why Bismarck likened them to sausages: it is better not to see them being made. Yet UN laws are not quite like other laws. First, they are subject to no higher authority—no Supreme Court, for instance—than those who make them. Second, those who make them are not democratically appointed. They are therefore particularly vulnerable to the charge of dubious legitimacy.

That, of course, is a consequence of the nature of the institution, which tries to marry legitimacy with realpolitik. It is no good whining about the Security Council's lack of legitimacy if you wish it to reflect the distribution of power in the world: the council must recognise geopolitical reality or, like the League of Nations, it will surely fail. This, incidentally, is the rejoinder to be used against those like Mr Perle who draw attention to the unhappy fact that the vote of China, hardly a democracy, can alone make the difference between international legality and illegality. That's tough, but that's the real world.

No it isn't, reply the majority. The veto-wielders on the Security Council, the Permanent Five or P5, are simply the victors of the second world war, plus China. The ten other members are chosen from the ranks of the remaining 186 in the General Assembly. In a neat piece of rebranding, the ten non-permanent members have taken to calling themselves the Elected Ten, or E10, thus pointing up the questionable authority of what a Dutch ambassador in 1999 referred to as the Hereditary Five, a sort of international House of Lords.

Two of the P5—Britain and France—are well aware of the inappropriateness of their status. Both are declared nuclear powers and may claim to be warrior nations, ready, usually, to commit their forces to collective actions in faraway places. But if clout were measured by economic power and population, Britain and France would make way for their neighbour, Germany, even if their own professed belief in a common European foreign and security policy did not anyway suggest they should yield “Europe's seat” on the Security Council to an ambassador from the European Union. Britain and France support Germany's claim to a permanent place, but are not willing to cede their own. They know their membership is the main reason anyone takes them at all seriously on the world stage. That is why they strut so energetically at the UN.

Russia should be equally embarrassed but is not. It has nuclear weapons and great-power pretensions, but its economy is about the size of Belgium's. In its current diminished condition, it cuts a feeble figure, sometimes using the threat of its veto to block action (Kosovo), more often manoeuvring on the sidelines. China is happy to remain uninvolved so long as its relations with the United States remain stable and no other national interest is affected.

Several countries have excellent claims to join the P5. India, the world's biggest democracy and biggest Hindu country, is pre-eminent. But promoting it would reward its decision to go nuclear. It would also antagonise many Muslim countries, unless perhaps Indonesia (Muslim, and lots of people), Nigeria (partly Muslim, also populous) or Egypt (Muslim, big Arab state) were promoted too. In any event, Brazil (big) and Japan (rich) would also have to join.

How would such an unwieldy council ever come to a decision? Would some members be content to forgo the veto? (Japan says yes, Germany no.) Could you have a pacifist country (Japan, Germany heading that way) in a body charged with maintaining international peace and security? Would Pakistan go ballistic, literally, if India joined the club? Would Africans in general be content to be represented by Nigeria rather than South Africa?

Such questions have been exercising a “working-group” on Security Council membership for years. Everyone knows it is getting nowhere. The general diplomatic stalemate is the proximate reason, but the bigger one is that the United States is not pushing reform, not yet anyway. That is a way of saying that in a Security Council that truly reflected the geopolitical reality of today, only one country, the United States, would have a veto-wielding seat: the P5 would become the P1.

The arrogance of power?

Even those honest enough to admit this have grounds to be unhappy about the way the council behaves. One articulate Asian ambassador complains that the P5 act as though they own the council. They exercise their privileges, one being that the collective security structure can never be used against them or any state fully supported by one of them (read Israel), but see no corresponding responsibilities. Martin Chungong Ayafor, speaking for Cameroon last December, put his point thus: “[The Security Council] is composed of 15 members, but, little by little, it is becoming a body of five plus ten members.” When Ireland was on the council last year, its ambassador was heard to grumble that, for $1, he was able to read a leaked draft of Resolution 1441 in the *New York Times* before it was presented to the E10.

Such complaints about procedure probably seem esoteric to those whose main grouse about the Security Council is that it picks and chooses which of its umpteen resolutions it will actively enforce, those on Israel being the ones most often cited. Like many such complaints—about arm-twisting, vote-buying, selective support for the UN's wider attempts to constrain such practices as weapons proliferation—this is really aimed at the United States, not the P5. So, of course, is the charge that if the Security Council demurs from some enforcement action, the United States simply goes out and rounds up a “coalition of the willing”, much as a sheriff rounds up a posse.

But America has complaints of its own. For years, they were mostly aimed at the General Assembly. America was infuriated by the assembly's vote to equate Zionism with racism. It became exasperated with the inefficiency and expense of a huge bureaucracy. It has always hated the hypocrisy—born, of course, of the marriage between legitimacy and realpolitik—on show when Libya chairs the UN's human-rights commission or, as seemed likely till last week, when Iraq would chair its conference on disarmament. Many American politicians have made their names by railing against the UN, and America long withheld its dues; at the end of 2000 the arrears stood at $1.7 billion and, despite a deal since then, the payments issue is not fully resolved.

The outrage has often been disproportionate to the offence. Yes, the General Assembly says some silly things, but none of them is binding. Moreover, as Kishore Mahbubani, Singapore's ambassador, has pointed out, “Were the General Assembly to be perceived as a compliant American instrument, it would quickly lose the respect, trust and commitment of the 5.75 billion people who live outside the United States.” This explains the paradox “that the demonstrated independence of the General Assembly from US domination—while not serving short-term American interests—does indeed serve long-term American interests.”

The fuss over money seems excessive too. American pressure has done much to make the UN more efficient: budgets have been squeezed for years and so few people have been hired that the average age in the Secretariat, it is said, is becoming Methuselahian. Moreover, the total costs of the UN amount to only about $1 billion a year—compared with, for instance, the $380 billion defence budget requested by the Bush administration for 2004. In truth, America does not handle the UN very skilfully. As a recent report for the Council on Foreign Relations, an independent American group, points out, it is hampered by “frequent US reluctance to support international agreements without adequate explanation of US objections; the US practice of withholding...treaty-obligated dues; and long gaps in the confirmation of a US permanent representative to the UN.”

America does, nonetheless, have a point when it complains about the constraints upon action that the UN imposes. Sometimes these arise from a disagreement with a permanent member (Russian objections over Kosovo, French objections over Iraq); sometimes they arise from the words of the charter, which, being designed (largely at America's behest) to forbid war as a state policy and instead impose collective security as the norm, make it hard to launch an armed attack on a sovereign state. For a country like today's America, more interested in outcomes than in procedures, this is frustrating.

A flexible friend

Still, neither the United States nor its critics need despair. The UN has shown that it is capable of change; indeed even its constitution, the charter, is open to reinterpretation. An early example of that is the great-power veto, the foundation-stone of the Security Council yet not mentioned by name in the charter. Article 27(3) simply demands that all decisions should have the “concurring votes of the permanent members”, implying that an abstention should count as a veto. Subsequent interpretation, though, has come to treat abstentions as just that, abstentions.

EPA

Annan confronts the Rwandan failure

Similar evolutions have enabled the UN first to start and then to expand the practice of peacekeeping, which is not mentioned in the charter at all. But under the mandate of a fictive “Chapter 6½” of the charter, invented to mop up after the Suez expedition in 1956, countless peacekeeping operations have been undertaken, and their scope has been steadily widened, notably after the experience of Somalia and Bosnia in the 1990s, when the enforcement powers granted by Chapter 7 were expanded. As a result, UN “peacekeepers” such as those currently in Congo are authorised to protect not just UN personnel but also civilians under attack.

Even stranger, some authorisations nowadays come after the event. That was true, in effect, of the Ecowas operation in Sierra Leone in 1997 and also the Kosovo operation, which was in the end (1999) “authorised” *ex post facto* by the resounding defeat of a Russian resolution that would have condemned it.

All in all, though the UN saw some of its darkest days in the 1990s—the massacre in the “safe area” of Srebrenica being overshadowed only by the inaction in the face of genocide in Rwanda—it also demonstrated its capacity to adjust to changing circumstances. Indeed, in 1999 its secretary-general, Kofi Annan, enunciated a new doctrine that would have shocked most of his predecessors. Atrocities on a grand scale and the denial of democratic fundamentals should no longer be regarded as purely domestic matters, he said, thereby tossing out ideas about the inviolability of national sovereignty that went back to the Treaty of Westphalia in 1648.

So should America take heart? On the one hand, yes: the UN is an adaptable beast. It survived the 1990s, a period of American “passive hegemony”, with both successes and failures. A more assertive hegemony now confronts it, but it may accommodate to that too. Much will depend on the diplomacy of the next few weeks. No country nowadays wants to fall out seriously with the United States; that is why a resolution to 1441 may well be passed. What it says, and who supports it, will condition the legitimacy as well as the legality of what follows. Clearly, the stronger the majority in the Security Council, the more legitimate it will seem.

If, however, Iraq is not disarmed with UN approval to the satisfaction of America, an American-led posse will ride forth, and the Security Council will be badly damaged. That will be bad for the UN, and bad too for the United States. America could have gone to war a year ago without bothering to consult the UN. That it did not do so, despite the temptations, but instead resorted to months of cajoling, threatening and bribing countries like Angola, Guinea and Colombia (all present or recent members of the Security Council), was testimony to the UN's usefulness. Thomas Franck, of New York University Law School, likens the efforts to the old practice of rich men “buying” rotten boroughs to obtain a seat in the British Parliament: it was unedifying, but even so a mark of the esteem in which the institution was held.

Who will put Humpty together again?

America will surely find the UN useful, too, when the time comes to stop fighting in Iraq and to try to turn it into a decent country. An American occupation runs the risk of drawing the fire of every malcontent in the Middle East and acting as a recruiting agent for al-Qaeda farther afield. How much happier it will be if the difficult task of rebuilding Iraq can be dumped in the lap of something called the “international community”, alias the UN.

For their part, many of the 186 non-P5 countries will complain about America and the rest of the Security Council, especially if they see a follow-up resolution to 1441 as a UN authorisation of pre-emptive action, a precedent to make most sovereign states shudder. But the competition to join the E10 will still be fierce, even as it is today. Outside the UN, American conservatives may try to put together a club of democracies to authorise future armed interventions, but the two biggest that already exist, the European Union and NATO, are at present as riven as the Security Council. A third, the Commonwealth, may yet fall apart over one of its recalcitrant members, Zimbabwe. Do such clubs really offer an alternative to the UN?

In short, however justified the misgivings about the Iraqi episode, the UN is unlikely to go out of business. It has survived crises before, and been roundly condemned on all sides. It is now due for another buffeting. In the end, though, it satisfies a need. Singapore's Mr Mahbubani puts it thus: “Distance has disappeared. The world has shrunk to a global village. Every village needs a village council. The UN represents the only real village council we have.” Realists, especially American realists traumatised by September 11th 2001, can retort that every village also needs a policeman, and the only one on hand may be America. Council and policeman, let's agree, had better work together.

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America's strategy with Iraq

Full speed ahead!

Feb 20th 2003 | WASHINGTON, DC
From The Economist print edition

Getty

After a week of ritual hazing at the United Nations and on the streets of Europe, you might have imagined America would be preparing to retreat. It isn't

Get article background

IT LOOKS like a last effort to get the widest possible support for war against Iraq. Rebuffed last week in his first attempt, George Bush on February 19th decided to push for a “straightforward” new resolution at the United Nations Security Council authorising the use of force if Iraq does not disarm. As *The Economist* went to press, the timing, wording and reception of such a resolution were all in doubt. Would it simply assert that Iraq is in “further material breach”? Or would it set new demands, with a deadline for compliance? Would it be presented at the end of this week, as some officials had said, or later? When might it be voted on? And might France veto it?

Mr Bush's decision to propose a new resolution shows that his policy of seeking UN support has not been knocked off course by criticism. At the same time, the uncertainties surrounding any resolution reflect the hammering his policy has recently taken—and raise doubts about whether a new resolution will pass.

The Americans had originally hoped to put forward the resolution after Hans Blix's second report to the UN on February 14th. As they saw it, a tough report would back their claim that Iraq had failed to disarm, and must now face “serious consequences” (code for war). Yet Mr Blix's second report differed little from his first.

AP

El Baradei and Blix, the referees

Mr Blix repeated his claim that Iraq is not co-operating on matters of substance because it has failed to account for large quantities of chemical agents it is known to have possessed. He said Iraq has missiles with a range of more than 150 kilometres, which are banned under UN resolutions and must be destroyed, along with 380 illegal Iraqi missile engines. America and Britain say Iraq should be found in breach of its obligations if it omits any information about weapons programmes or if it possesses banned weapons. Mr Blix found Iraq guilty of sins of both omission and commission.

But in other ways, the report dashed American hopes. Mr Blix said progress was being made on process—that is, on Iraqi co-operation with the inspectors. Iraq has now permitted flights of U-2 surveillance planes and has allowed a few Iraqi scientists to be interviewed in private. He said his team's job could be completed in a short time if Iraq provided “immediate, active and unconditional co-operation”. Nine of the 15 members of the Security Council, including veto-wielding France, China and Russia, argued that the inspectors should therefore be given more time (something the Americans might not mind if it were brief) and that progress short of complete compliance is reason enough not to authorise war yet.

Next Mr Blix and Mohamed El Baradei, the head of the International Atomic Energy Agency, argued that better surveillance and expert help could ease the problem of Iraqi non-compliance. This contradicts the American view that no amount of inspectors will ever be enough in a country as big as Iraq, with a regime as slippery as Saddam Hussein's, and that, anyway, the inspectors' job is not to catch Mr Hussein hiding something, but to verify that he is disarming.

To add insult to injury, Mr Blix took issue with parts of the evidence that Colin Powell had presented to the Security Council the week before. He cast doubt on the secretary of state's photographs “proving” Iraq was moving chemical weapons out of the back door as inspectors arrived at the front. Mr Blix said the activity shown could have been routine.

Mr Blix's mixed report might have been explained away, but what happened next could not. In their speeches to the council, the various foreign ministers turned doubts about America's case into a near-rout. Dominique de Villepin, France's foreign minister, drew hearty applause from the delegates when he said war was tantamount to failure and should be used only as a last resort.

To get a second resolution, the Americans need the support of nine of the 15 council members and must avoid a veto from any of the five permanent members. In their remarks, only three of the 15 backed America (Britain, Spain and Bulgaria), while the overwhelming majority of ordinary UN members, addressing the council this week, argued for patience. Before America's proposal of a second resolution, Jacques Chirac, the French president, said there was no need for one now, and went further than he had done before in threatening to veto it. If used, a French veto would be the first since 1956.

This St Valentine's Day Massacre of American hopes was then followed by some of the largest anti-war rallies ever seen in Europe. The biggest demonstrations were in capitals of governments that support America: London, Rome and Madrid. America's interpretation of Iraq's position—it is guilty until it proves itself innocent to the inspectors—may be closer to the letter of Resolution 1441. But popular opinion in the rest of the world seems to back the opposing French view of the resolution—that force should not be authorised until inspectors have had more time to reveal weapons of mass destruction.

A former French Europe minister said all this amounted to a “stinging defeat” for a “humiliated” America.

One chastened administration official conceded it was now up to America to make the next move, telling *Time* that “difficult decisions [will now] have to be made in Washington.”

No change in the White House

Yet the striking thing about these events is how little they have actually altered America's policy, or its calculations. Mr Bush dismissed the demonstrators, saying he should no more change course because of them than conduct policy by focus group. He has not been dissuaded from a second resolution, though its language may be more equivocal than it might have been a week ago. His calculation seems to be that last week's diplomatic battle exaggerates the real difference between America and its critics over the timing of any war.

At the Security Council, Mr de Villepin said the council should postpone any decision about war for a month, until a fourth report from Mr Blix, which the French want on March 14th (in practice it may be earlier). That date could become just one more opportunity for delay, of course. But if the French accept that a final decision should be made by that time, then the difference between their view and the American position is only two weeks, because Mr Bush wants a decision after Mr Blix's third report on February 28th.

Such optimism may seem absurd in view of the diplomatic and popular anti-Americanism of the past week. Yet as the administration sees it, these events are not the setback they appear. Agreement on a second resolution might still be possible. But even without one, America would not be fighting alone, or just with Britain. In addition to Britain and Australia (the two countries which would join it in fighting), America has the support of half the current members of the European Union, all the countries applying to join and most of NATO. The coalition is hardly trivial.

The administration had hoped that the Turkish parliament would pass a law on February 18th, allowing the deployment of American troops to open a second, northern front in any war against Iraq. That was put off. The Turks want more aid than the $26 billion America is offering; they want a firm guarantee that the Kurds of Iraq will not get within a mile of independence; and they are nervous about public opinion (a poll at the end of January showed that 94% of Turks were against an American attack on Iraq).

The White House is getting increasingly grouchy about this, but it still regards the Turkish problem as soluble. The Turkish government has let in 3,500 American troops to upgrade ports and airbases. The United States is said to be pressing for up to 80,000 troops to be allowed in; the Turkish government is ready for only half that number. This disagreement could be finessed by moving the first troops rapidly into Iraq through air bases that are already used to patrol the no-fly zone over parts of Iraq.

From the administration's point of view, this picture is symptomatic. Mr Bush's team tends to divide its problems into two sorts. One set is important (to America) but exaggerated or manageable: for instance, it can deal with the split over Iraq by a new resolution. The second set of problems is harder to solve—the long-term future of the UN for instance (see article)—but Mr Bush seems prepared to live with the consequences.

Foremost among the problems America cares a lot about is Tony Blair's position. Mr Blair has been the foremost advocate of a second resolution—a big reason why America is proposing one. But even if the resolution were to fail, the administration still reckons Mr Blair will have arguments to sway his hostile public. The military campaign, the Americans argue, will be short and overwhelming—and when Iraq is liberated, the victors will find compelling evidence of weapons of mass destruction and of Saddam's atrocities. This, they reckon, will vindicate Mr Blair.

The administration is also confident it can heal the transatlantic rift—at least over Iraq. Given the outbreak of anti-European (especially anti-French) opinion in America, one might be forgiven for thinking the administration has given up on its European allies. Yet for all the clamorous rhetoric and hurt feelings, Mr Bush's people argue that the alliance will stick together. They point to NATO's decision to patch up its differences and lend Turkey aircraft and anti-missile systems to defend itself against possible Iraqi attack. They also take comfort from the EU statement this week explicitly supporting the use of force against Iraq (albeit as a last resort).

By contrast, the administration is more ambivalent when it comes to the debate about the EU's common foreign policy. This is a long-term, strategic concern for the United States. But as an immediate tactical

matter, the White House argues that the dispute is none of its business: it is a matter for member states.

In short, as the administration sees it, there are problems, but no cause for panic or policy adjustment. Yet this concerns the pre-war phase. Perhaps the two biggest questions about Mr Bush's calculations, though, concern the future.

The first centres on the post-war settlement. America will need allies afterwards to help rebuild Iraq. The administration maintains that the allies will come running. Iraq is one of the two or three most important countries of the Gulf. It has the world's second-largest oil reserves and is a vital member of OPEC. The administration reckons other countries will be beating down the door to “help out” afterwards as a way to gain a foothold of influence. That remains to be seen.

The second larger question concerns the longer-term future of the transatlantic alliance. Regardless of Mr Bush's *sang froid*, the past week has seen the most dramatic upheaval in the alliance for decades. Even if the administration is right to say that specific divisions on Iraq are overblown, it may still be blind to the deeper damage the dispute has done to the transatlantic alliance. The real legacy of St Valentine's Day and the demonstrations may not emerge for years.

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The Democrats

Divide and don't rule

Feb 20th 2003 | WASHINGTON, DC
From The Economist print edition

The more Democrats want to be president, the happier the Republicans

THE Democratic Party is busy proving the truth of the old saw that no American politician can look in the mirror without seeing a president in the making. This week three more Democrats, Carol Moseley-Braun, a former Illinois senator, Dennis Kucinich, a fourth-term congressman and, most formidably, Dick Gephardt, the party's former leader in the House, added their names to the five declared candidates (Howard Dean, John Edwards, John Kerry, Joe Lieberman and Al Sharpton). Other possible volunteers include a former candidate (Gary Hart), three sitting senators (Bob Graham, Christopher Dodd and Joseph Biden) and an ex-general (Wesley Clark). The party could easily end up with a dozen names.

Is this profusion of candidates evidence of the Democratic Party's vitality? Or is it yet another example of its unfitness for power? So far, the signs are not good.

The number of candidates provides yet more evidence that the Democrats are deeply divided over everything that matters—from a looming war with Iraq to the North American Free-Trade Agreement with Mexico and Canada. Mr Lieberman is a staunch free-trader and Iraq hawk. Mr Kucinich, on the other hand, voted against the resolution that gave George Bush the authority to take military action against Iraq. He promises to be a “people's president”, living in a “worker's White House”, and his first act will be to nullify NAFTA.

Some Democrats argue that the size of the field will allow “serious” candidates like Mr Lieberman to differentiate themselves from “fringe” figures like Mr Kucinich. But this is easier said than done.

Many “fringe” candidates have vocal supporters among the interest groups that dominate Democratic primaries. Both Ms Moseley-Braun—the first black woman elected to the Senate—and Mr Sharpton, though slightly tarnished characters, speak for black activists that the Democrats too often take for granted. Mr Sharpton, a fiery orator with an infectious sense of humour, will be particularly difficult for the party establishment to marginalise. Other “fringe” candidates will be hard to ignore because of their expertise: think of Mr Dean's record as a health-care reformer when he was governor of Vermont and (if he runs) Mr Clark's military clout.

The biggest problem for the Democrats is that this huge field will probably drag the party further to the left. Left-wing candidates will inevitably hog the headlines. Three candidates are outspoken opponents of the administration's policies on Iraq. Mr Sharpton supports reparations for slavery. Mr Kucinich wants to create a federal “Department of Peace”. Mr Dean, a supporter of universal health insurance, draws loud applause when he says that he represents “the Democratic wing of the Democratic Party”.

More mainstream candidates may have to move leftwards to appease the party's base, which hates George Bush with a fury. Mr Gephardt will have to protect his trade-union support from Mr Kucinich. Even the determinedly centrist Mr Edwards has taken to saying he is not “Republican-lite”.

Stirring the pot, the Republicans are on the watch for anything they can depict as disloyalty to America. They have made a fuss about Jimmy Carter signing a peace petition circulated by a British tabloid—and thus, they claim, breaking the convention that ex-presidents keep quiet about controversial issues. Wait till they get hold of Messrs Kucinich and Sharpton.

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Michigan's budget woes

The lady's in a straitjacket

Feb 20th 2003 | LANSING
From The Economist print edition

Not her fault, she says

AP

Granholm does the sums

WHEN Michigan's voters put Jennifer Granholm into the governorship last autumn, they did so because they were tired of stodgy old Republicans, and wanted a fresh face and new ideas. But the smart young Democrat wears a fiscal straitjacket inherited from her predecessor, and is warning her state of tough times ahead. “I need everyone to understand the seriousness of the budget crisis,” Ms Granholm said on February 17th.

Two days later, she unveiled her plan to close the expected deficit of $158m in the general funds budget for this fiscal year, which ends in September, and quickly won the legislature's agreement. Police, prisons and universities will all be cut back. She had already hacked $127m out of the schools budget, which is separate in Michigan. Far more brutality will be required before these budgets can be agreed for the next year, when the total deficit is an estimated $1.7 billion.

Other governors might envy her position. Michigan's budget deficit is smaller than that of many other states, and its economy has been doing relatively well. Anyway, Ms Granholm is Michigan's third governor in a row to enter office with a budget deficit facing her.

But a legacy from the 1990s of tax cuts and “creative borrowing”, as it is politely called, weighs heavily on Ms Granholm. State agencies, local governments and universities are all wondering how far belt-tightening will have to go. Out on the road this month to tell Michigan's people what the deficit means for them, the governor boiled it down to a 20% cut in state services—hardly a popular message.

Already, the governor has begun to sound like one of those tight-fisted Republicans. She has called for savings in contracts with outside vendors, a pay cut for legislators if other state workers' wages are slashed, a reduction in the fleet of state vehicles, and the use of “every sheet of stationery in existence, even if my predecessor's name is on them”. Now everyone is waiting for the other shoe to drop. “There's been no real hurt yet,” says Al Short, a lobbyist with the Michigan Education Association. He reckons the true pain will start on March 6th, when Ms Granholm outlines her plans for next year's budget shortfall.

Rebecca Ross, a senior economist with the state House Fiscal Agency, says the trouble began with tax changes in the 1990s. There was a big cut in local property taxes. Plans were also adopted to chip down income tax over time (it is now 4%, and is due to fall to 3.9% next year) and to phase out the business tax by a tenth of a percentage point per year over 23 years. The net result was a large reduction in state revenue. To complicate matters, previous administrations borrowed everywhere they could: they reached into the Stabilisation Fund, the Medicaid trust fund and the unemployment trust fund. “They've robbed every cookie jar already,” says Ed Sarpolus, an opinion pollster.

School districts have less leeway in Michigan than elsewhere since state taxes largely replaced local property taxes as the source of the schools' money. This eliminated large inequalities in school incomes, but it may limit the districts' options in tough times.

However desperate things get, Ms Granholm says she will not raise taxes. Michigan's Democrats still remember 1983, when two Democratic state senators were thrown out of office after a roll-call vote on the state income tax. Their replacement by Republicans tipped the balance in the upper house, and John Engler became majority leader before going on to claim the governor's mansion.

There was one bright spot for the governor this week. Mercy High School, a Roman Catholic girls' school near Detroit, reversed an earlier decision and reinvited Ms Granholm to take part in a school fund-raiser this Saturday. The governor had offered students and mothers a chance to have lunch with her. The offer was rejected by the school after parents, alumnae and a group called the Stop Granholm Church and Truth Project objected to her policy on abortion. (The governor, who is a Catholic, says she personally opposes abortion but supports a woman's right to choose.)

Now the lunch is on again. Perhaps Ms Granholm will whet the students' appetites with the story of the pain tax cuts can cause long after they have been made.

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South Carolina

The homeless governor

Feb 20th 2003 | COLUMBIA
From The Economist print edition

Well, it nearly came to that

AP

He does his own shirts, too

HOW cheap is Mark Sanford? As a Republican congressman, he slept on a futon in his Washington office rather than rent an apartment. A far-from-poor former property-financier, he has always been famous for his frayed shirts. When he was elected governor of South Carolina last year, he shelved the inaugural ball in favour of a barbecue. Now he has offered to save money by closing down the governor's mansion until July. The Sanfords and their four young sons would stay in an upstairs flat, doing their own cooking and laundry.

Fortunately for the heroic Mrs Sanford, a group of local businessmen, convinced that the mansion is a powerful attraction in luring investors to the state, seem to have saved the day, offering $100,000 to keep the big house open. Mr Sanford still insists he will have to save money by inviting people for breakfast (not dinner, which costs more). He has already got a local firm to supply free grits. And he may bring prison inmates back to work in the mansion: the cons were kicked out by the previous governor because they were caught having sex too often.

Mr Sanford's parsimony is certainly needed. South Carolina's budget has a $340m shortfall in the current fiscal year, which ends on June 30th, and an even bigger hole is forecast next year with cuts in services inevitable. Mr Sanford's predecessor was criticised for spending too much on his accommodation. But will politicians in other governors' mansions around the country appreciate the precedent he has set?

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Education in the South

Doing it at home

Feb 20th 2003 | ATLANTA
From The Economist print edition

Education reform in the South still has troubles—except for home-schooling

EDUCATION has not had a happy history in the southern states of America. For nearly a century they seemed more interested in keeping white and black students apart than in what children should actually be taught. Other Americans sniff at the region's academic performance. Its schools are famous for scorning Darwin in favour of creationism; its universities are looked down on by the Ivy League as heavily subsidised football factories.

This caricature, many southerners claim, should now be dismissed. They admit they still lag behind the rest of the country, but insist that this makes them keener to experiment. Both George Bush and Bill Clinton became president after being southern governors who made their name in education. Education reform has happened "far faster and to a greater depth" in the South, claims Jonathan Hull, a representative for the Southern Legislative Conference. Consider:

Swete home Alibama
NAEP assessment scores*, 2000

	Reading aged 10†	Maths aged 14	Science aged 14
Alabama	211	262	141
Arkansas	209	261	144
Florida	207	264‡	142‡
Georgia	210	266	144
Kentucky	215	272	152
Louisiana	204	259	136
Mississippi	204	254	134
North Carolina	217	280	147
South Carolina	210	266	142
Tennessee	212	263	146
Texas	217	275	144
Virginia	221	277	152
South average	**211**	**267**	**143**
National average	215	274	149

*Maximum score is 500 †1998 ‡1996
Source: National Centre for Educational Statistics

•**Testing.** Almost all the southern states now administer their own assessment tests. Texas's testing programme is one of the most comprehensive in the country, raising standards every year and sending school-report cards to parents. President Bush's No Child Left Behind Act, passed last year, was based on the Texan model.

•**College scholarships.** Here the leader has been Georgia, with a programme that gives college scholarships to students with a B average or better, funded since 1993 by a state lottery. Zell Miller, the governor who staked his career on this project, is now a well-loved Democratic senator in an increasingly Republican state. That, too, has been noticed outside Georgia.

•**Choice.** The South has been sluggish when it comes to vouchers for students at awful public schools to use at private schools, though Florida has a voucher programme. Charter schools—private schools that are given public money—are illegal in Alabama and Kentucky, but have done well in Florida, Texas and North Carolina.

•**Home-schooling.** Thanks to pressure from evangelical Christians, this is generally easier in the South. Alabama, Kentucky and Mississippi require only that parents notify the authorities of the intention to teach children at home; Texas does not ask even that much.

And the results? The reformers admit that the experiments do not always work. Vouchers remain controversial everywhere. The non-partisan North Carolina Centre for Public Policy Research points out that six of the state's ten lowest-ranked schools are chartered ones.

Some naggers worry that the reforms make it possible for religious fundamentalists to "miseducate" children. In South Carolina, one of the main providers of textbooks for home-schoolers is Bob Jones University, which says it "stands without apology for the old-time religion and the absolute authority of the Bible." But in his successful campaign for the governorship of Tennessee, Phil Bredesen, a Democrat who was mayor of Nashville, boasted of bringing in a curriculum that included teaching the existence of Buddhism and Hinduism to second-graders. (The local Republicans duly attacked this for not reflecting "Tennessee values".)

Most parents would be prepared to forgive the odd church-state squabble if their schools were getting better—and there are some signs that they are. In national exams, ten of 12 southern states saw their ten-year-olds' reading scores improve between 1994 and 1998; all 12 have seen their 14-year-olds' maths scores rise. The southern states have climbed above the national average in the proportion of their population with high-school diplomas.

Yet, by most measures, southern schools still lag (see table on previous page). Black children, the focus of many of the reforms, do particularly badly. In South Carolina last year less than 70% of black students passed the reading portion of the annual exit examination, as opposed to 89% of white ones and 72% of Latinos. Education Trust, a non-profit think-tank, reckons that black students in most southern states are three years' worth of learning behind their white peers. And the schools may be slowly re-segregating. A recent Georgia State University study found that white teachers have been leaving black-majority schools.

The new problem is money. Governors like Mr Bredesen have all just come to power, pledging to improve things but inheriting enormous budget deficits. Tennessee's voters approved a lottery for education in November, but that money might go to reduce the state's looming $800m budget deficit. Alabama voted down a lottery in 1999, and its schools, paid for almost exclusively by sales taxes, are especially vulnerable. The universities have already been hit: North Carolina has cut $52.3m from its university system, Georgia $78m. Even the billions offered by Mr Bush's No Child Left Behind Act look less of a windfall, since states would have to pay for the accountability tests.

It would be nice if all this led more southern governors to brave the teachers' unions and experiment with vouchers. In fact, the part of the reform movement that is likely to do best is home-schooling. It saves the states money. Home-schooled students have generally scored well in the national tests. And it keeps busy conservative parents who might otherwise insist on defending their darlings against Buddha and Darwin. These are all things that southern politicians appreciate.

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Football v French

No contest

Feb 20th 2003 | RISON
From The Economist print edition

Arkansas gets its priorities right

FRIDAY-night football is as important a tradition as Sunday-morning church in Rison, a small town in south-central Arkansas. The Rison Wildcats have won the Arkansas school football championships seven times since 1970. Now “school consolidation” has enraged both the football fans and the preachers.

Last month, Governor Mike Huckabee proposed reducing the state's 310 school districts to about 116. This has set off a bitter division in the legislature between advocates of state-controlled education and those who prefer local autonomy. One local Democrat, Jim Jeffress, has even referred to consolidation supporters as “Nazis”.

In fact, Mr Huckabee's hand was forced by the Arkansas Supreme Court. In November it decided that the state “had not fulfilled its constitutional duty to provide the children of this state with a general, suitable and efficient school-funding system.” The court ruled that the state, not local school boards or administrators, must come up with a better system by 2004. Its specific complaint was that some courses, such as French, calculus, creative writing and drama, were available only to students in bigger school districts. Small rural districts do not have French teachers, but they often employ ten football coaches.

Some really small schools will be abolished completely (taking with them their teams and mascots). The Rison school district, which comprises one high school, one middle school and one elementary school, will merge with another small district, probably Kingsland.

In a town where quarterbacks are more valued than quadratic formulas, this is shameful. What sane school would ditch one football coach just to learn French? The team, moan locals, is meant to represent only Rison. Family traditions have been broken. Cheerleaders, born to step into their mothers' tennis shoes, will no longer be naturals for the pom-pom line-up.

You might think pupils would welcome a broader education. But most rural Arkansans disagree. The fiercest opposition has come from preachers, who think local rights are being trampled on. Somehow the idea has been stirred up that consolidation means urbanisation, with gangs, guns and drugs.

Mr Huckabee, a former preacher himself, is in a pickle. Normally, he is a fan of decentralisation, and the Democratic legislature is the one trying to consolidate things in Little Rock. This time, the Democrats have the teachers' unions and local parents behind them. Mr Huckabee, who is thinking about running for the Senate in 2004, is now receiving hate mail from elementary-school children begging him to stop their schools turning into urban battlefields.

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Blizzards

White out

Feb 20th 2003
From The Economist print edition

FOR the one in three Americans who live in the north-east there was only one story this week: snow. The worst blizzards for a decade dumped up to four feet of snow. At least 50 people were killed by the storms. Several of them died of carbon monoxide poisoning in their cars as they kept engines running to stay warm. Thousands were stranded at airports after flights were cancelled; American Airlines cancelled a quarter of its schedule. Amtrak fared better by running empty trains to prevent fresh snow settling on the tracks. The centre of Washington, DC, ground to a halt for three days. The mayor of New York claimed each inch of snow cost the city $1m, and predicted a total bill of $20m. Maryland estimated its tally would be even bigger. Some of the payment could come from fines collected from people caught driving for “non-essential” purposes. For many people, the Presidents' Day holiday weekend lasted at least one extra day.

AP

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Lexington

Old America v New Europe

Feb 20th 2003
From The Economist print edition

Who has been lying about whose age?

THERE are few more enduring assumptions about transatlantic relations than that Europe represents age and America youth. Americans reflexively dismiss Europe as a clapped-out old continent—a wonderful place to visit but hardly the anvil of the future. Europeans, equally reflexively, dismiss America as the embodiment of all the evils of modernity—a testosterone-driven adolescent bereft of history and tradition.

The quarrel between age and youth is inevitably infecting the debate over Iraq. When Donald Rumsfeld talked about “old Europe”, he was pointing out—a little mischievously—that there is more to Europe than France and Germany. But his remarks reminded Europeans of those American snubs about “structural rigidities” and “fear of the future”. Now Dominique de Villepin, the French foreign minister, hopes to trump Mr Rumsfeld by turning France into a symbol of the whole continent. “This message comes to you today from an old country, France,” the tanned Gaul told the United Nations, “from a continent like mine, Europe, that has known wars, occupation, barbarity.”

But is the age difference between Europe and the United States really so big? Granted, Europe's history goes back a good deal further than America's. Granted, Europe has chateaux and schlosses while America has the Disney castle and McMansions. But the world's first new nation is hardly a spring chicken. The early settlers arrived in Virginia and Massachusetts when the first Queen Elizabeth was on the throne and England was not yet Britain. Harvard University was founded in 1636. The Declaration of Independence was signed a century before the unifications of Germany and Italy. “The youth of America is their oldest tradition,” Oscar Wilde quipped more than a century ago. “It has been going on now for 300 years.”

Despite its youthful population, America is often more wedded to traditional values. American churches are full every Sunday with worshippers dressed in their finery. Public events regularly begin with a performance of the national anthem. American tabloids eschew the naked breasts that bounce all over their European cousins. What is political correctness but Victorian prudery in modern dress? This week some Harvard students took advantage of the weather to build a giant snow penis. Their prim contemporaries immediately destroyed it.

The American political system is one of the oldest in the world—far older than those upstart regimes in France and Germany. America has the world's oldest written constitution (drafted in 1787) and two of the world's oldest political parties (established in 1828 and 1854). The United States is the world's oldest surviving democracy. America has done little more than tinker with its constitution since 1791 (such as introducing the direct election of senators in 1913). France has had five republics since 1789, along with several monarchies, one directory, a consulate, a couple of empires and a collaborationist-fascist dictatorship. Uncle Sam's face is rightly that of an old man.

Americans are also much more inclined than Europeans to solve today's problems with reference to the wisdom of their ancestors. Americans routinely make monumental decisions—such as whether people can carry guns or whether women can have abortions—with reference to the designs of a group of 18th-century gentlemen who wore knee-breeches and powdered wigs. Politicians happily describe themselves as Jeffersonians and Hamiltonians. While books on the Founding Fathers regularly top the American bestseller lists, Europeans are less happy to dwell on some parts of their history—and not just the obvious world wars. The Spaniards are touchy about the Franco era. For many east Europeans history seems to have started in 1989. Americans tend to avoid some bits of their past—notably what they did to the American Indians—but they have managed to cast most of their history, including the civil war, as part of their struggle for freedom. The past can be wallowed in safely.

Reconstructive surgery

And what about the idea that only youthful America can re-invent itself? Well, it is actually those fusty old Europeans who are engaged in a radical experiment—a bid to create a “new Europe” that is more than a collection of countries but less than a unified state. The Maastricht treaty is not yet a teenager, the common currency is barely out of nappies, a new constitution is being debated, ten new members are due in 2004 (France willing), there is still talk of a “common foreign policy”. The Washington traditionalists, though, seem happy with their constitution.

Rather than being about Europe's old age, the transatlantic divide arguably has more to do with Europe's attempt to become something utterly new—and with America's inability to appreciate this. In his timely book, “Of Paradise and Power: America versus Europe in the New World Order” (Knopf), Robert Kagan argues that Europe is trying to find a “post-historical paradise”—a self-contained world built on transnational rules and negotiations. The United States, by contrast, remains “mired in history”—trapped in a Hobbesian world of power politics in which international laws are unreliable and true security depends on your ability to bash the bad guys.

Critics have cheerfully picked holes in Mr Kagan's thesis. Isn't the European Union deeply divided over Iraq? Isn't France using the Iraqi fracas to pursue its ancient dreams of national glory—by reasserting its leadership in Europe and embarrassing the American hyperpower? Yet Europe's gigantic peace movement suggests that Mr Kagan may have a point. Large numbers of Europeans don't want to have any truck with the Hobbesian world. Whether in so doing Europe is summoning up the wisdom of an old continent, or just engaging in a fit of adolescent posturing, remains to be seen. But Americans who go on about the old world should take a look in the mirror first.

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Bolivia

What will the IMF say now?

Feb 20th 2003 | LA PAZ
From The Economist print edition

The president has survived a devastating assault. But the price has been high

Reuters

Get article background

ON FEBRUARY 12th, incredulous but enthralled, Bolivians watched live broadcasts of the army and the police turning their guns on each other. What ensued was perhaps the worst period of civil disorder the country has seen since its “popular revolution” of 1952.

It began at midday, in the usually tranquil Plaza Murillo in the centre of La Paz, as troops attempted to prevent stone-throwing youths from smashing the windows of the presidential palace. The youths were protesting against government spending cuts and a new income tax; but among them were large numbers of armed police on a wild-cat strike. The troops used tear gas; the police responded with tear gas of their own. Both sides then turned to bullets. Twenty-seven people died, and at least 100 were seriously injured.

President Gonzalo “Goni” Sánchez de Lozada, appealing for calm, ordered the troops to stop fighting. The result was 24 hours of mob rule. With no police or soldiers about, crowds ransacked and burned public buildings, hauling out furniture and computers to fuel the flames of street fires. Even the vice-president's office, a national monument that houses the congressional archive, was burned. Generalised looting followed, with businesses identified as foreign—Burger King, the city brewery, the Coca-Cola bottling plant—suffering most. Copycat riots and looting followed in towns across the country.

Although a fragile peace has now been restored, marches continue, and confidence in the government has plumbed new depths. The bloodshed has shocked everyone, as have the photographs of rooftop snipers picking off unarmed civilians. It is said that the government placed them there, though officials deny it.

In the government's view—broadly hinted, rather than declared—the opposition was behind the rioting. Some are calling it a coup attempt. “It's important”, said Mr Sánchez de Lozada, “that we reflect on the clear attempt there has been to destabilise democracy.” To convince those who pooh-pooh this, the government has asked the Organisation of American States to help investigate the events and to find those responsible.

The government insists it had no advance warning about the mood of the police. A spokesman laid the blame squarely on the last government and the “tremendous promises made to almost everybody”—promises that the present government cannot afford. Last year's budget deficit, which soared to 8.6% of GDP, cannot be repeated, and a new deal with the IMF and some $4 billion in loans depend on raising more revenue.

Yet in order to get the police back on duty, the government agreed to withdraw its budget proposals from Congress. This includes the proposals for new taxes. And even with serious spending cuts, the government cannot hope to fill a $240m hole in the public accounts without expanding the tax net. Higher taxes on oil companies, already announced, may bring in around $80m, but the industry is suing to stop them. The income-tax measure was to have raised the bulk of the remainder. Now the government will be unable to meet the deficit-reduction targets demanded by the IMF. In the interests of stability, the Fund and multilateral lenders may now show more understanding; but they have not done so yet.

The riots have also raised doubts about another ambitious revenue-earner, the scheme to ship some of the country's liquefied natural gas to the United States and Mexico. This was unpopular anyway, both because of animosity towards America and because a port in Chile, Bolivia's old enemy, would probably be used to export the gas. The armed forces, in particular, resent the use of Chile; and Mr Sánchez de Lozada now owes them his life since last week's attack on his palace. “More than ever,” says Napoleon Pacheco, the head of an independent economic think-tank, “the government will have to take account of those views.”

The cabinet has now resigned en masse, giving the president a chance to reorganise and to cut costs. Moira Paz, a politician rather than a technocrat, has been given the top economic job. Five ministries are said to be going and, as a gesture, Mr Sánchez de Lozada (who is rich enough) has renounced his salary. But Bolivians, who gave him only 22.5% of the vote in last June's election, will be hard to convince. Even if Mr Sánchez de Lozada has saved his presidency, he may no longer be able to save his country's economy.

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Canada

Northern tiger loses growl

Feb 20th 2003 | TORONTO
From The Economist print edition

First signs that Canada's economy isn't doing quite so well

Get article background

OVER the past two years, Canadians have discovered that they are not doomed to catch a cold every time their giant neighbour sneezes. While America has teetered on the edge of a double-dip recession, the Canadian economy has kept expanding. It grew by 1.5% in 2001 and 3.3% last year, the best performance among the G7 industrial countries. In contrast to America's spiralling budget shortfalls, Canada's current account as well as its budget remain in tidy surplus. The Bank of Canada raised interest rates three times last year; with inflation rising, it has hinted it may do so again.

A true “northern tiger” is how John Manley, Canada's finance minister, described his country when he put his 2003-04 budget to Parliament in Ottawa on February 18th. Committing the Liberal government to its sixth balanced budget in a row, he insisted that “we will maintain our capacity to control our own destiny”.

This may be easier said than done. Though many Canadians might wish it were otherwise, their dependence on their southern neighbour has grown rather than diminished over the past decade. America's share of Canada's exports has climbed from 73% to 85% since the two countries signed a free-trade agreement in 1988, reinforced six years later by the North American Free-Trade Agreement, which also includes Mexico.

The recent divergence between the two economies is partly explained by Canada's lower dependence on the battered telecoms and technology sectors. The terror attacks of September 2001, too, caused less nervousness among Canadian businesses and consumers than American ones. Meanwhile, the car industry, based mostly in Ontario, has seen record sales on both sides of the border. Alberta's oil and gas producers are basking in higher prices. And low interest rates have kept the housing market humming.

But recent data suggest that the weakening American economy is now starting to take its toll to the north. The motor industry has lost its shine, and housing starts fell 8.7% in January. Statistics Canada reported this week that factory orders have been sliding since last autumn; factory inventories have risen for five months in a row, the longest string of increases in almost three years.

Craig Wright, chief economist at the Royal Bank of Canada in Toronto, is still confident that the North American economy will take off once the uncertainty over Iraq is resolved, and that Canada's real growth rate will again exceed 3% this year. But even he acknowledges that “the risks seem to be building on the downside”. JP Morgan, an investment bank, estimates that growth slowed to 2% in the fourth quarter of 2002 and only about 1.5% in the first three months of this year.

In this week's budget, his first, Mr Manley wisely set aside C$4 billion ($2.6 billion) for unexpected contingencies and “economic prudence” in the year ahead. Yet his priorities are different from those of his predecessor, Paul Martin, whose first emphasis was to put a lid on government spending and then, more recently, to cut taxes. The centrepiece of Mr Manley's budget is an 11.5% jump in discretionary spending in the fiscal year to March 2004, the biggest increase in more than two decades. His budget speech was a cornucopia of handouts—for health care, child care, defence and parks, among others.

The switch in fiscal priorities has much to do with domestic and, especially, Liberal Party politics. This week's budget was not just Mr Manley's first, but also Jean Chrétien's last. The prime minister plans to retire next February after more than 40 years in politics. The budget was one of his last chances to burnish his legacy.

In crafting their strategy, both Mr Manley and Mr Chrétien have been looking over their shoulders at Mr Martin, who remains the clear front-runner for the top job. Mr Manley, a mild-mannered former tax lawyer who is also deputy prime minister, is pondering whether to join the leadership race. He needs to raise his profile and his popularity if he is to have any chance of catching Mr Martin. What better way than by handing out goodies to all and sundry on budget day?

Mr Chrétien, who forgets neither his friends nor his enemies, seems to have hit on the budget as a device to tie his successor's hands. Many of the spending promises announced this week are three- and five-year programmes, with the bulk of the funds earmarked for the later years. The question now is whether Mr Martin, assuming he occupies the prime minister's seat on budget day 2004, will want to stick to the script that Mr Chrétien has written for him—and whether he will want Mr Manley to read it.

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Mexico

Where do babies come from?

Feb 20th 2003 | MEXICO CITY
From The Economist print edition

The president's wife will tell you

That part is not in the guide

LUCKY Mexican mums and dads. They now have a new parenting guide issued by the Vamos Mexico Foundation, which is run by Marta Fox, wife of Vicente Fox, the president. More than 20m copies are being handed out. Mrs Fox has certainly found the killer answer to the question, “Where do babies come from?” Children should be told: “From the state of Mexico.”

The guide, produced in collaboration with the teachers' union and several other non-governmental groups, has landed the hyper-active Mrs Fox in her hottest water to date. It is not just nannyish (“The television is not a nurserymaid”), but strictly conservative. Sexual abstinence is encouraged, and the word “condom” side-stepped. The guide not only condemns divorce outright, but makes a constitutionally dubious attack on abortion. Critics say it might as well have been written by a priest.

That would not matter but for the involvement of Mrs Fox, herself a divorcee, and the perception that she is using her position to push her own conservative Catholic agenda. Vamos Mexico has even asked the education ministry to let schools be used to hold discussions of the guide—despite the legal separation of church and state.

Just as controversial is the fact that Mrs Fox's collaborator, the head of the teachers' union, is none other than Elba Esther Gordillo—who is also the secretary-general of the PRI, the main opposition party to Mrs Fox's husband. Just deft politics? Or some nifty coalition-building for a presidential bid in 2006? Mr Fox has already said that he would like a woman to succeed him.

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Peru

Bald man meets blonde

Feb 20th 2003 | LIMA
From The Economist print edition

The old spymaster in the dock at last

Get article background

EPA

Montesinos isn't talking

MORE than 1,000 police had been called in. Riot police on horseback, snipers and special forces in combat gear guarded the perimeter of Lurigancho prison, encircled by shanty houses climbing up grey desert hills. Police had combed the prison after rumours that some of the more dangerous inmates were planning a riot while the cameras were there.

A helicopter landed; and out stepped Vladimiro Montesinos, wearing a bullet-proof vest. He had been flown from the naval jail, where he has been held since June 2001, to Lurigancho prison to be tried. Until this week, he had avoided a public trial for building a rotten state-within-a-state when he was ex-President Alberto Fujimori's spymaster. Now he is in the dock at last, facing 57 charges.

Mr Montesinos's tactics have included challenging the authority of all the judges he has faced. But the delays are not all his doing. The judges have taken four months to decide where he should be tried. (The courtroom was not ready until the last minute; the paint was still sticky on the railings.) Several serious charges against him have been shelved, though that is being appealed. As with the failure, so far, to persuade Japan to extradite Mr Fujimori—after six months, the Supreme Court has yet to have his file translated—it is hard to tell whether this is judicial incompetence or something more sinister.

Ronald Gamarra, the special state prosecutor for human-rights cases, says that the judges are honest; but they lack initiative and, in some cases, the steel to force deeper investigation. “We've advanced a lot in the anti-corruption system,” he says, “but that is not enough: we need judges to really take charge of this process.”

If there are cracks in the system, Mr Montesinos will certainly try to exploit them. His strategy has always been to co-operate on the minor stuff, but deny charges that carry harsher sentences. (Each human-rights charge against him could jail him for 25 years.) The first case he faced on February 18th, for influence-peddling in favour of two relatives of his former lover, Jacqueline Beltran, is small beer compared with corrupting judges, running guns and ordering death-squad killings.

In an expensive silk shirt and dark trousers, the balding Mr Montesinos sat staring ahead for more than five hours. Even when his blonde former lover, in a lilac-blue jacket and long white dress, screamed at him to “be a man” and admit that the favours were all his idea, Mr Montesinos refused to speak or glance at her. His lawyer said he would not say a word because he does not recognise the court's authority.

His silence may come as a relief to some. Old partners-in-crime may well prefer him dead, and old cronies still in office could pull strings for him. Mr Montesinos ran a vast web; more than 1,300 members of it are under investigation. A master of blackmail, he also filmed his meetings compulsively, and may have videos in reserve for when the going gets rougher. As, if the judges keep their nerve, it will.

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Ecuador

So far, so good

Feb 20th 2003 | QUITO
From The Economist print edition

Lucio Gutiérrez finds friends abroad but doubters at home

FOR a left-leaning former army officer and coup-leader, Lucio Gutiérrez went down surprisingly well in Washington. Barely three weeks after becoming Ecuador's president, he was having an hour-long meeting with President George Bush and pledging, in his opposition to drug-trafficking and terrorism, to be America's "best friend". He was also snaring an IMF deal that will release $500m in multilateral loans. He has done so by making solemn promises that he will use Ecuador's oil revenues to pay off the country's debts. But his eagerness to clinch IMF support may cost him dearly at home.

Faced with a probable debt default and a budget gap for this year estimated at $2 billion, or 8% of GDP, Mr Gutiérrez has adopted some decidedly centre-right measures. Within a week of taking office he increased the price of petrol by a third, froze public-sector wages for a year and talked of introducing new taxes. Days later he announced a gradual rise in electricity tariffs, increasing the average bill by more than 10% over the next six months. His budget for 2003 promises a fiscal surplus for this year of around $250m. Almost the only signs that he is still left-wing at heart are the fact that he has cut his own salary by 20% and started jogging to work.

But his economic plan carries big political risks. The IMF is demanding tax modernisation and a big reduction in public-sector jobs. It also wants international administrators for the state electricity and telecoms companies, and a cut in the subsidy on domestic cooking gas.

Though the president's popularity seems solid enough, he has had to walk on eggshells to preserve his coalition with Ecuador's Andean Indian farmers. They feel betrayed by the price increases and disappointed at the government's $6.7 billion budget, which devotes more than a third of this year's revenue to debt-reduction and only a quarter to social spending. The Indian political party, Pachakútik, seems sulkily persuaded that Mr Gutiérrez will concentrate on their needs eventually; the Conaie, the biggest of the Indian movements, has given him 30 days to "mend his ways". If he does what they want, such as reversing the fuel-price increases and sacking his economic team, the IMF will not like that much.

The president must also convince Congress to vote for economic reform. It comes in the shape of three bills. The majority opposition alliance may back a law to crack down on corruption in the customs service, but it is unlikely to support the tax and civil-service-reform bills that will go to Congress later in the year.

Mr Gutiérrez's critics are also worried by the military cast of his government. Several important posts have gone to former army colleagues, including the presidencies of the state telephone companies, the state oil company and a number of ministries. Mr Gutiérrez, who has already forced out 17 generals, is now proposing a 40.5% increase in military expenditure, creating speculation that he is tightening his grip on the army. Troops have been turning up alongside the police to fight crime, and at the ports to control the customs authorities. There has even been talk of putting the police under the control of the defence ministry as a fourth branch of the armed forces. Mr Gutiérrez's family has been favoured, too, with relatives and in-laws taking jobs in the government.

The challenges facing the president are serious, and he may not overcome them. But his visit to Washington suggests a clever strategy: that by getting America and the international financial community on his side, he becomes a much harder man for Congress to oppose.

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South Korea

The bumpy road ahead

Feb 20th 2003 | SEOUL
From The Economist print edition

Roh Moo-hyun, to be inaugurated on February 25th, can expect no honeymoon

Get article background

WHEN South Korea's outgoing President Kim Dae-jung took office five years ago, it was in the depths of the Asian financial crisis. South Korea faced bankruptcy, and was forced to seek a multi-billion dollar bail-out from the International Monetary Fund: its largest ever loan. Grappling with that crisis, which forced the government to introduce tough economic reforms and restructuring programmes, dominated much of Mr Kim's term.

His successor, Roh Moo-hyun, who will be inaugurated on February 25th, now faces not just another crisis—the deepening stand-off over North Korea's nuclear ambitions, underscored this week by a violation of South Korean airspace by the North—but an appalling tragedy, in the shape of the fire on an underground train which, on February 18th killed 125 or more people in the southern city of Daegu. The blaze was caused by arson but greatly exacerbated by the apparent absence of sprinklers and by a cut-off of power. Mr Roh has already said his inauguration will be scaled down as a mark of respect. But his government is likely to have to get to grips with a scandal relating to safety measures on South Korean public transport.

He will certainly also have to deal with another scandal, this one over payments apparently made to North Korea in 2000 to ensure that its leader, Kim Jong Il, attended a summit meeting with Kim Dae-jung. Mr Kim and Mr Roh come from the same party. Mr Roh has already landed himself in trouble by suggesting that the matter be dealt with by a parliamentary probe, rather than a full judicial inquiry. On top of all this, Mr Roh faces an upswell of anti-Americanism at home—a vice of which he himself is sometimes accused—which is bound to make his relations with South Korea's most important ally considerably more complicated.

Of all the many problems on his plate, buffing up Mr Roh's relationship with America is likely to be the one that will receive the most urgent early attention. Tempers in South Korea are still running hot following the acquittal in November of two American soldiers charged with negligent homicide in the deaths of two teenage girls who were run down by an American armoured vehicle on a training exercise in June. Huge street protests and candlelight vigils at the time of the acquittal heard calls for the revision

of a legal code governing the status of the 37,000 American troops stationed in South Korea. Among the crowds were more radical groups calling for the complete withdrawal of American soldiers from the peninsula.

The wave of protests is thought to have helped Mr Roh to a narrow win over his conservative rival, Lee Hoi-chang. Mr Roh himself once called for the withdrawal of American forces—although he now says he sees things differently. But he has still called for a more “balanced” relationship between America and South Korea.

Since winning the presidential election last December, Mr Roh and his aides have been working to re-cast his image. His opponents have sought to portray him as a dangerous radical, who is anti-American, anti-big business and pro-labour. His supporters say many of his views have been distorted and misrepresented. “He's a rising star; and he's not very well known to the public,” says one of Mr Roh's top aides, Chyung Dai-chul, an MP, who headed a delegation as Mr Roh's envoy to America and Japan earlier this month, to prepare the ground for an early summit meeting. Mr Roh has so far never visited America. “Some areas have been misunderstood—including the perception among some that he supports anti-Americanism. That's not the case.” But already there have been differences: last month, Mr Roh spoke out strongly against economic sanctions on North Korea while America was still considering them. And he says he will “not allow” a military strike against the North, something America has pointedly not ruled out.

At home, Mr Roh and his team have spent the past few weeks trying to win over not just his domestic critics—by including an unprecedented visit to the offices of the opposition Grand National Party—but also public opinion among the foreign community in South Korea. The president-elect recently took part in an honour-guard ceremony at the headquarters of America's forces in Korea, and talked of the value of the half-century-old alliance between the two nations. At a meeting hosted by the American and European Chambers of Commerce, he promised to continue the reform of the country's key economic sectors. He has also granted a series of carefully chosen interviews with the foreign media—targeting a mainly American audience.

Meanwhile, Mr Roh's transition team has been working to fine-tune the plans that he hopes to start implementing soon. He sees his main objective as uniting Korean society, meaning on his side of, rather than across, the demilitarised zone. That includes doing something about South Korea's marked regional imbalances; cutting the gap between rich and poor; fighting corruption; and ensuring a free and fair market system. The tasks are enormous. Yet Mr Roh, like his predecessor, is up against a hostile majority in parliament that cannot be changed until late next year at the earliest. He has broken the mould already, being only 56 and lacking a university degree in a country that generally reveres age and education. But delivering on all the expectations he has aroused will be very much harder. With relations with North Korea running into complications because of the North's nuclear ambitions, and the opposition snapping at his heels, Mr Roh's presidential passage will not be an easy one.

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North Korea

Fireworks

Feb 20th 2003
From The Economist print edition

And there could be more to come

AS CELEBRATIONS go, there were plenty of fireworks. While North Koreans were this week celebrating the 61st birthday of their leader, Kim Jong Il, the country's armed forces threatened to pull out of the 1953 armistice agreement that ended the Korean war (though North Korea stopped observing it fully some years ago). In recent months Mr Kim's regime has also admitted to enriching uranium, ended a freeze on its plutonium production, turfed out inspectors from the International Atomic Energy Agency and withdrawn from the Nuclear Non-Proliferation Treaty. Last week the IAEA reported North Korea's transgressions to the UN Security Council, saying it could no longer verify that the regime was not diverting nuclear material to make weapons.

The council could eventually impose sanctions on the North, though for now all involved, including America, South Korea, Japan, China and Russia, say they want a diplomatic solution. That is looking more remote by the day. North Korea has said that it would take any move to impose sanctions as an act of war. And in any nuclear exchange, it claims, North Korea would be bound to triumph.

Much of this has been dismissed so far as bluster. South Korea's outgoing president said this week that he believed the danger of war to be “non-existent”. Economic talks between North and South Korea continue, as do recently inaugurated visits by South Korean tourists using a special corridor across the heavily fortified border.

Yet there are two big dangers. One is that North Korea will let off some real fireworks: it has not yet started reprocessing spent fuel from its previously “frozen” nuclear programme, but if it does, it could have enough plutonium for five or six bombs (to add to the couple it may already have) in a matter of weeks and could even test one; and it could resume testing its far-flying missiles. George Tenet, the director of the CIA, told a Senate committee last week that North Korea has an untested missile thought to be capable of striking America's west coast.

The other danger is of a rift between America and South Korea. Its president-elect, Roh Moo-hyun, speaks openly of a “difference of opinion” with America. Both agree North Korea should not have nuclear weapons, but Mr Roh insists on only peaceful means to deal with the problem. That assumes North Korea would be prepared to negotiate away its weapons if the right deal were offered. Opinion in the Bush administration is divided on this issue. But privately some Japanese officials and some South Korean ones increasingly have their doubts. North Korea is doing nothing to reassure them.

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Afghanistan

Learning to love the market

Feb 20th 2003
From The Economist print edition

Goodbye to state-owned companies

Reuters

Get article background

AFSOTER'S days of glory are long past. During the Soviet occupation of Afghanistan, the state-owned company ran a fleet of some 2,000 lorries, handling all the transport needs of the tentacular public sector. Today, there are a lot more Afsoter lorries circulating on the black market—priced at $10,000-$15,000—than on the company's parking lot in Kabul. The company still has an office and staff, but does no work to speak of.

There are an estimated 150 state-owned companies in Afghanistan, a legacy of the country's centrally-planned past. Some of them, such as Ariana, the national airline, are still in business. But with over 1,500 employees on the payroll and only half-a-dozen aircraft, the company is hardly efficient. Hamid Karzai's interim government is banking on an economic future driven by the private sector. The new investment law is designed to be business friendly. Red tape has been cut to a minimum, say officials. Some 2,300 investment projects have been approved over the past nine months, more than over the past 45 years, the minister of commerce proudly claims. Travelling exhibitions promote Afghanistan abroad as a good place to do business.

Mr Karzai has set up a commission to look into the scope for privatisation of state companies. But at present it is unclear which state companies are still active, and what assets they have. The government has no money to spend on them with a view to making them more attractive to possible buyers. Many are likely to be liquidated, but a few may interest buyers. The country's six state-owned banks have not granted loans or taken deposits for a long time but, according to Torek Faradi, a senior adviser to the Central Bank governor, their names and office buildings have value. Property in Kabul is in demand. A building in central Kabul, or even a building site, could be attractive to foreign agencies or businesses at present facing rents of $5,000 a month, when they can find premises at all.

The positive signs for business in Afghanistan are the government's plans for reconstruction, the flow of aid money to pay for them, and cheap labour. Siemens has just reopened an office in Kabul, after a 20-year absence. Standard Chartered Bank may follow. The bank is used to difficult environments—it kept operating in Sierra Leone during the worst of the civil war—but is concerned about security in Afghanistan. Poor roads and an unreliable power supply add to the security problems that deter potential investors. Lack of government expertise in supporting an embryonic private sector and the remnants of Soviet-era mentality are other deterrents.

So most of those investing in the country have so far been Afghans living abroad, such as Ehsan Bayat, the founder of Telephone Systems International, based in America. The company has invested over $60m—the largest private investment in the country's history—to establish Afghanistan's first mobile-phone network. It started building the network after the Taliban were ousted, at a time when few foreign companies were tempted to move in. The network hoped for 5,000 subscribers. It now has more than 25,000. This sort of start-from-scratch project looks a better prospect for investors than crumbling state companies.

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Malaysia

No breaks

Feb 20th 2003 | KUALA LUMPUR
From The Economist print edition

Malaysia's deprived Indian minority gets none of the benefits reserved for Malays

Reuters

Malaysia's underdogs

PEOPLE of Indian origin account for only 8% of Malaysia's total population, but they make up 14% of its juvenile delinquents, more than 20% of its wife- and child-beaters, and 41% of its beggars. They make up less than 5% of successful university applicants, and own less than 1.5% of the country's share capital. To make matters worse, they are not eligible for any of Malaysia's lavish affirmative-action programmes, which are reserved for Malays and other indigenous people. Other countries may have upwardly mobile Indian immigrants, but Malaysia is fast developing an Indian underclass.

The problem stems from the decline of Malaysia's rubber plantations. British colonialists shipped indentured Indian labourers to Malaysia in the late 19th and early 20th centuries to tap rubber. After independence, many Indians stayed and became citizens, tapping rubber all the while. But over the past few decades of breakneck economic growth, developers have ploughed up many rubber plantations to plant less labour-intensive oil palms, or to build shopping malls and housing estates. The displaced workers and their families have wound up in shanty towns on the outskirts of Malaysia's cities.

Until recently, the government largely ignored the problem. The many well-to-do Indian doctors and lawyers, after all, help to give Indians higher incomes on average than Malays. Many Indian labourers, even, earn more from odd jobs in the cities than rural Malays do from fishing or farming. But unlike poor farmers, explains Denison Jayasooria, the head of an Indian think-tank-cum-charity, they have to buy their own food, pay rent, and travel to work—all at inflated urban prices.

Jaya Partiban, a senator from the Malaysian Indian Congress, the biggest Indian political party, says that the sheltered life of the plantations imbued Indians with a culture of dependence. Furthermore, argues P. Ramasamy, a professor at the Malaysian National University, Indians have little prospect of advancement, since Malaysia's Chinese minority dominates business, and Malays control the bureaucracy. Indians often complain of neglect or discrimination at the hands of civil servants, and harassment by the police.

All these frustrations boiled over into a race riot in a squatter community outside Kuala Lumpur in March 2001. Six people died and scores were injured. To this day, many Indians live in rusty corrugated-iron shacks in Kampung Medan, the scene of the riot. They complain that jobs are hard to come by, especially since employers fear that many Indians may be involved in crime. Although the police have set up three posts in the area since the riots, locals say, only one of the officers staffing them is Indian. There are no

playgrounds, sports fields or clubs to tempt their children away from street gangs. The local Indian school, they add, is in a dire state.

The government has at least pledged to change all this. It has promised to move all squatters in the area to subsidised housing by 2005. It is hiring more Indian teachers. It is also financing the Yayasan Strategik Sosial, Mr Denison's outfit, to develop schemes to help poor urban Indians. Most dramatically, it has declared its intention to double Indians' stake in Malaysian companies by 2010—the sort of race-based target normally reserved for Malays. As it is, government officials like to point out, Malaysia's richest man is an Indian: Ananda Krishnan. His fellow Indians, however, tend to view his success rather more cynically; they joke that Mr Krishnan takes up the community's share of the national wealth all by himself.

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China

Against the grain

Feb 20th 2003 | NIULANZI VILLAGE, SHANDONG PROVINCE
From The Economist print edition

Local officials won't help farmers

AP

On his own

Get article background

IN THE grip of its worst drought in a century, Shandong Province in eastern China is encouraging county governments to hand out free grain to the neediest, and to lend grain interest-free to any farmer who wants it. The problem is that some debt-plagued local governments do not want to foot the bill. In the dusty village of Niulanzi, where the drought has ruined harvests for the past three years, residents say local officials are if anything making their plight worse.

Even though Shandong is one of China's wealthiest provinces, the lowest tiers of rural government are, as almost everywhere else in the country, overwhelmed by the burden of paying for education, healthcare and their own bloated bureaucracies. Their problems are a legacy of tax reforms in 1994 that gave the central government a bigger share of the pie and left them with much less. In times of disaster, rural administrations now are more inclined to drag their feet.

Shandong's drought has left some 9m farmers short of grain, of whom 2.6m also lack enough money to buy the supplies they need. Villagers in Niulanzi and the nearby settlements of Chengkou Township say the water shortage has been exacerbated by pollution from a state-owned factory which has made their nearby river unusable for irrigation or drinking by farm animals. The factory denies responsibility.

Last year the county, like other drought-affected areas of Shandong, began lending grain to farmers deemed capable of paying it back. But the grain on offer is of poor quality. In Niulanzi, villagers are afraid that officials will demand repayment with better quality grain. *News Weekly*, a state-owned publication, reported in December that many local governments are disinclined to lend grain at all. They fear that lending grain to peasants at a time of disaster is like lending pigs to a tiger: you will not get them back.

News Weekly also pointed out that the grain lending policy can further impoverish those farmers who do not meet requirements for free handouts but who are nonetheless very poor. In Niulanzi, half of the 2,000-odd villagers depend on agriculture for their livelihood and are afraid of becoming indebted to the local government.

Villagers say that in spite of central government orders to the contrary, local officials are refusing to

waive the usual agricultural tax, payable in grain or cash, as they are supposed to do in times of hardship. Those who cannot pay in full are forced to surrender goods instead. One resident estimates that about 80% of farmers in Niulanzi have had household goods confiscated in lieu of tax. A farmer says, “They bully ordinary people. They lock you up, saying it's against the law not to pay your tax. They say nothing about the conditions for farmers this year.”

One villager says he decided last year to submit a petition to the provincial government about the polluted river. Some 100 other farmers signed his testimony (though none from Niulanzi, where he says most villagers are scared of upsetting officials). In July, he sneaked out of the village at night and ran several kilometres into nearby Hebei Province to avoid being spotted by staff at local bus stations who he says are under orders to stop villagers from leaving the area to petition higher authorities. From there he made his way to Jinan, the capital of Shandong. But his petition, he says, was disregarded.

On discovering your correspondent talking to villagers, officials from Chengkou Township summoned the county police who confiscated notes and ordered that photographs taken on a digital camera be erased. The township later sent a delegation to Beijing to insist that no news be published about the plight of the villagers.

For Niulanzi's villagers, this year is unlikely to bring much relief. According to the state media, water flow in the Yellow River, from which the settlement draws its (dirty and expensive) drinking water, could drop to its lowest level in 50 years this spring.

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Thailand

Slaughter of the drug dealers

Feb 20th 2003 | BANGKOK
From The Economist print edition

Thaksin's remedy in a nation of millions of users

POLITICIANS often use battlefield phrases to trumpet their tough stance on key issues. But a declaration of a “war on drugs” by Thailand's prime minister, Thaksin Shinawatra, is turning out to have particularly ferocious effects. In the first three weeks of a three-month campaign that began on February 1st, nearly 600 suspected drug dealers have been killed, according to government figures, and thousands more are in police custody, many voluntarily.

Police say they killed only a few dealers who resisted arrest. The rest are said to have been killed as a result of violence among the dealers themselves. The dealers, it is claimed, killed anyone they believed was informing against them. But human-rights groups say Mr Thaksin, a former policeman himself, is covering up for the activities of security forces said to be carrying out extra-judicial killings. The government has denied any such activities.

Opposition politicians, among them Mr Thaksin's predecessor, Chuan Leekpai, have questioned who exactly is killing the dealers, and have given warning that the slaughter will damage Thailand's international reputation. Some activists want the United Nations to investigate, but the government says it would be too busy at this time to receive an envoy. Relatives of those killed are also pressing for an investigation.

Apart from such voices of dissent, however, Mr Thaksin's tough talk appears popular; pollsters report overwhelming approval of his anti-drugs campaign. If anything, the campaign is likely to intensify in the run-up to April 30th, by which time Mr Thaksin aims to rid “every square inch” of Thailand of drugs. Provincial governors and police chiefs who fail to arrest sufficient numbers of traffickers face the threat of demotion or worse. But eliminating all drug traffickers in a nation with millions of users is going to be a Herculean task.

Some say Mr Thaksin is winning applause for taking the fight to the drug dealers, and that voters will not penalise him if the pills keep flowing after April 30th. But the risk is that by encouraging local politicians and police to use brutal means to keep their jobs, the government will be left with blood on its hands that won't wash away easily.

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Palestinian reform

Arafat looks to more ceremonial days

Feb 20th 2003 | EAST JERUSALEM
From The Economist print edition

AP

Yasser Arafat agrees to devolve power, but Gaza reveals the remoteness of peace

Get article background

GRADUALLY Yasser Arafat is easing himself out of day-to-day power. On February 14th the old autocrat said he would appoint a prime minister, thus bowing to the demands of the Middle East "quartet" (America, the European Union, the UN and Russia) which has been insisting that reform of the Palestinian Authority (PA) is basic to its "roadmap" for ending two and a half years of bloodshed. Over the next few days, that blood flowed fast, with the Israelis killing some 20 Palestinians in three punitive attacks on Gaza.

The appointment of a prime minister, said Mr Arafat, would come after changes had been made to a draft Palestinian constitution by the PA's parliament and the Palestine Liberation Organisation's Central Council (the first representing the West Bank and Gaza; the second, Palestinians at large). Both bodies have been prevented by Israel from meeting in recent months.

The constitution as it stands envisages a presidential regime. The quartet wants a more parliamentary system, with Mr Arafat transferring many of his executive powers to a cabinet headed by an "empowered prime minister". At meetings in London this week between the quartet and the PA (which had been barred by Israel from a similar meeting last month), there was an attempt to put flesh on the skeleton.

Who will the new prime minister be? Only one thing so far is clear. Salam Fayyad, the PA's able finance minister whose economic reforms have been generally praised, has ruled himself out of the running, declaring that he would not be "a candidate in any kind of framework [that] weakens the...elected leadership of Yasser Arafat". Mahmoud Abbas (also known as Abu Mazen) has been less categorical. He is already the PLO's de facto second-in-command, and would probably be the choice of Mr Arafat's Fatah movement.

Most agree that Mr Arafat's decision is a step in the right direction. Why has he taken it? One reason was the warning he got from the quartet that unless he made credible reforms, he was in danger of receiving roughly the same treatment from Israel as the Americans are preparing for Saddam Hussein. Another was the advice from colleagues (Mr Abbas chief among them) that he must make the changes now, ahead of any war with Iraq, if there is to be a Palestinian regime left to reform.

The Palestinians' fear is that Ariel Sharon will use the window of America's war on Iraq to close down what remains of the Oslo peace process, either by forcibly evicting Mr Arafat or by reoccupying the Gaza strip. With the West Bank already reoccupied by the Israeli army, Gaza is the last redoubt of PA rule. It is also the bastion of the PA's emerging and irrepressible alternative, the Islamist Hamas movement.

In recent weeks the PA's policemen have been making an effort to stop Hamas guerrillas from firing rockets from Gaza into Israel. On another tack, Mr Arafat has offered the Islamists top positions in the PLO's ruling bodies if they agree to abide by a Palestinian ceasefire. In response, Hamas has held some of its fire, curbing the rocket attacks and, some say, its suicide bombers; the last claimed Hamas suicide attack inside Israel was in November.

Hamas had also signalled that it might be prepared to turn this temporary restraint into a more permanent “understanding” that civilians inside Israel would not be attacked so long as the Israeli army stopped invading Palestinian areas and assassinating Palestinian militants. But it has firmly ruled out any end to “armed resistance” against Israeli soldiers, or against settlers in the occupied territories.

Fame and punishment

Armed resistance has been winning Hamas fame, and punishment. On February 15th, its guerrillas killed four Israeli soldiers by detonating a huge bomb beneath their tank, an ambush virtually every Palestinian sees as a legitimate act of resistance. Israel, naturally, did not deem it legitimate, and acted accordingly. Within hours, six Hamas men were blown away by a bomb in a pilotless plane they were assembling, the latest weapon in their armoury against Israel. Hamas said the bomb had been planted by Israel, and Israel said nothing to suggest otherwise.

The next day tanks and Israeli undercover squads swept into northern Gaza, razing the home of a Hamas militant, killing two Palestinians in a gun battle and abducting Riyad Abu Zied, a leader of Hamas's military arm, who died on his way to hospital. Another Hamas man was shot dead “resisting arrest” near Hebron in the West Bank. An even bigger onslaught came on February 19th, when 40 Israeli tanks entered Gaza City, killing 11 Palestinians, including three civilians who were buried in their home when a metal workshop next door was blasted by tank shells.

Another Palestinian died by detonating himself before the tracks of a tank. There will be more of that, promised Aziz Rantisi, a Hamas political leader, but next time inside Israel. Few Palestinians believe he is bluffing: with eight of its militants killed in three days, Hamas is bound to mount a response. The first reaction was four rockets pitched into Israel. Talk of a “ceasefire” seems at an end.

Meanwhile, Mr Arafat has decided to walk the hard road of reform, hoping that, in return, the world will exert pressure on Israel to get out of his cities and back to negotiations. But most Palestinians now believe that Mr Sharon is so bent on “regime change” that nothing will thwart him, not even the timely appointment of a “credible” prime minister.

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Kuwait, America and Iraq

My best friend's war

Feb 20th 2003 | KUWAIT
From The Economist print edition

Kuwait looks forward to war, though harbouring a doubt or two

Get article background

AP

And entrepreneurs say so too

WHILE millions elsewhere were marching against war, Kuwaiti schoolchildren last week were handing Valentine roses to American marines. The event, like the billboards saying “God Bless US Troops” that grace bits of Kuwait, including the city's busiest square, was staged for western cameras. Yet Kuwait's enthusiasm for war is not fake. It is nuanced, tempered by feelings that range from excitement at post-war business opportunities, to a sense of obligation to the friend that chased out Iraq in 1991, to anxiety at being hurt in war or ostracised by fellow Arabs, to doubt about America's real ambitions in the region.

The equation is simple, says a contractor who supplies American forces: “80% of us support invading Iraq, but 99.9% of us totally oppose American policy on Palestine.” A Kuwaiti academic, freshly returned from America, expresses a similar sense of disjuncture. In America, she would vote against George Bush, protest at globalisation and march against war. Here she finds herself wishing to end the “oil narcosis” of Kuwait's nanny state, yearning for more openness to counter creeping Islamist atavism, and longing for war.

Support for America is certainly solid enough for most Kuwaitis to keep their doubts quiet, even as 100,000 western troops romp across the half of Kuwait's territory which is now barred to its own citizens, and even as other Arabs and Muslims chorus their anger at America's “recolonisation” project. It is not simply that Kuwaitis want revenge for what Saddam Hussein did to them, or that they hope to free the 600-plus Kuwaitis missing in Iraq since the last war. Many say that after their own brief taste of life under Mr Hussein, they understand the suffering of Iraqis, who have endured him for 30 years.

Kuwaitis also want to see their country resume its traditional role in the region. The 1980-89 Iran-Iraq war, followed by Iraq's invasion of Kuwait and the subsequent 12 years of sanctions, cut off the emirate from family and trading ties in its natural hinterland. While liberals complain that separation has encouraged seepage of religious conservatism from Saudi Arabia, Kuwaiti Islamists complain that it is American culture that has infiltrated, corrupting Kuwaiti youth. In plush shopping malls, tight jeans vie with veils, just as on Kuwait's airwaves blaring pop clashes with Koranic recitation.

Since liberation, the emirate's old city-dwelling elite has sensed a loss of influence to newer arrivals from tribal backgrounds. The *hadar*, as settled bedouin are known, tend to have larger families and lean towards religious conservatism. In Kuwait's feisty but ineffectual parliament, Islamists have blocked reforms such as granting women the vote. Radicals have opted for *jihad*, praising Osama bin Laden and mounting their own sporadic attacks against the infidel “invader”. This is another reason why Kuwaiti liberals, reluctantly in many cases, want war.

“It's a gamble, and what Americans bet on, and we are betting, is that everything will change with the reception Iraqis give to a new regime,” says Jassem al-Saadoun, an economist. The risk is that clumsy attempts to impose a regional Pax Americana would reconfirm suspicions that America is more interested in punishing Arabs than improving their lot.

Meanwhile there is much money to be made. By some accounts, creating and supplying the American army's huge desert tent-cities has already injected as much as $2 billion into Kuwait, equivalent to 6% of

GDP. Local caterers scoop more than $1m a day feeding the troops, and services from haulage to warehousing to cleaning and sanitation are booming.

Car rental agencies report that a secondary market has developed, with American officers subletting four-wheel-drive vehicles at a 50% mark-up. The price of black-market whisky has risen by a similar margin. One firm has filled an urgent order for 100 live chickens in cages, to be used as canaries in case sophisticated chemical-weapons detectors fail.

And there is more business to come. Kuwaiti suppliers say orders have already been placed for goods to be delivered into Iraq, with some contracts extending for five years. Local businessmen anticipate a bonanza from Iraqi reconstruction. “Iraq just needs a jumpstart, a few volts and it'll be ready to roll,” says a businessman who recalls the days when Basra, a mere two hours drive away, was dry Kuwait's favourite watering hole. “Our wives won't even know we're out of town.”

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The Kurds in northern Iraq

On their best behaviour

Feb 20th 2003 | ARBIL
From The Economist print edition

But Kurds, Americans and Turks do not share the same goals

Get article background

JEALOUS neighbours—Arab, Persian and Turk—used to be able to sow discord among Iraq's fractious Kurds, seemingly at will. No longer: a new unity prevails. Since last autumn, when their regional parliament held its first full session in eight years, the two main Kurdish groups, the PUK and the KDP, have shown surprising pragmatism. Jalal Talabani, the PUK's leader, says that the two groups are even talking about unifying their administrations, and setting up a combined military command. With the prize of self-determination at last within their grasp, Mr Talabani and his former foe, the KDP's Massoud Barzani, have come together in their longing for a war of “liberation”.

Kurdish officials parrot some of the wilder statements of the American administration. Barham Salih, Mr Talabani's “prime minister”, laments that the UN is becoming an “irrelevance”, and repeats the improbable charge that Ansar al-Islam, a band of Kurdish Islamist assassins, has produced chemical weapons. Officials obligingly identify the Ansar's unlikely pairing of non-executive directors: Osama bin Laden and Saddam Hussein.

Kurdish unity is good for Kurds, but too much of it worries the non-Kurdish groups that America has designated, along with the KDP and the PUK, to be Iraq's visible opposition. In the run-up to a long-delayed conference of opposition parties, scheduled to start outside Arbil some time this week, some of the participants privately doubted whether the Kurds would join the other groups in strenuously opposing the American plan to entrust the running of Iraq to an American military governor. The Kurds, or so the others fear, will fight hard for a federal structure and for control over their internal affairs, but may give way on American proposals for a deliberately sluggish transition to democracy.

The groups that claim to represent Iraq's Shia Muslim majority are particularly perturbed by the prospect of an American military governorate that may incorporate former Baath party elements. Officials from the biggest of these groups, the Iran-based Supreme Council for Islamic Revolution in Iraq, pronounce themselves aghast. This may well reflect the apprehension of their paymasters in Tehran, who shudder at the thought of living next door to an American administration.

Don't bother us now

The Americans, concerned with finalising their military plans, are far less interested than the opposition parties are in drawing up a blueprint for postwar Iraq. This week, American, Kurdish and Turkish soldiers met on the border between Turkey and Iraq, no doubt to talk about the military intervention into northern Iraq that the Turks are insisting they will carry out in the event of war. Besides stemming an expected flood of refugees into Turkey, these troops will act as a reminder to Iraq's Kurds, whose current autonomy is eyed enviously by Turkish Kurds, not to grab more territory or privilege.

The opposition conference is considered something of a distraction by the Americans, as they bargain with Turkey over the price Turkey is exacting for an American military thrust into northern Iraq. Zalmay Khalilzad, Mr Bush's envoy, is determined not to let the groups draw up the “leadership structure” that they say they want in place by the time the war starts. And since Turkish observers will be on hand at the conference, the Kurds will be on their best behaviour.

Moreover, unless Mr Hussein mounts a pre-emptive strike against the KDP or the PUK, the Kurdish warriors have been ordered by America to stay put in any coming war. This may go against the grain for

a martial race, but it represents a victory for the new Kurdish pragmatism.

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Zimbabwe's politics

Two houses divided

Feb 20th 2003 | BULAWAYO
From The Economist print edition

Can the opposition and the ruling party talk about power-sharing?

Get article background

JUDGED by its actions, Zimbabwe's government is in no mood for compromise. Jeeploads of soldiers patrol the streets, guns sprouting from open windows. Morgan Tsvangirai, leader of the opposition Movement for Democratic Change (MDC), is on trial for his life with two colleagues, and ten opposition MPs and civic leaders have been arrested and tortured this year. President Robert Mugabe, meanwhile, is blithely attending a Franco-African summit this week in Paris, having won an exemption from an EU travel ban.

Yet some opposition leaders think they can still hold fruitful talks with the ruling party, ZANU-PF. Partly, this is a counsel of despair. The MDC has been hamstrung since Mr Mugabe rigged a presidential election last March. Some of its leaders belatedly wish they had called strikes after the stolen vote. But Mr Tsvangirai refuses to lead protests that could provoke worse repression and end any pretence at democracy. In addition, his treason trial is, as he says, “like having a noose around your neck”. He rather vaguely suggests that “people take action themselves”.

Frustrated younger activists call him a coward. Some want violence; others say he should at least visit more hungry villagers, and spend more time talking to people in the food and fuel queues where Zimbabweans spend so many of their waking hours. Lovemore Madhuku of the National Constitutional Assembly, another dissident group, says of the MDC that: “They've no idea what they want to do; people are beginning to lose faith in Morgan Tsvangirai.”

The ruling party has its own splits, too. A more economically literate group, including the finance minister, Herbert Murerwa, worries about the economy. Fearing that Mr Mugabe is leading the party to ruin, some calculate that if they cut a deal with the MDC, they may be able to hang on to power. This could have been the thinking behind an offer of secret talks, reportedly made in December by Emmerson Mnangagwa, an ally of Mr Mugabe since 1976 and a possible successor, who oversees much of ZANU's business empire.

Chinese whispers

Mr Mugabe, who was apparently not told of the offer, was said to have been furious. The MDC cautiously rejected it, but is now sounding amenable to the idea of open and official talks to tackle the economic and food emergency. David Coltart, an MDC leader in Bulawayo, says that the party might agree to join a transitional government dominated by ZANU, so long as there was a promise of early elections, to be run by an independent body.

Are ZANU leaders really ready to deal? Some may be, especially if the MDC drops its legal challenge to last year's vote. Sikhanyiso Ndlovu, a member of the Politburo, asks what the ruling party must do to get international travel sanctions lifted, since “we are not a monolithic party, not everyone is a bad potato.” Another old leader, Eddison Zvobgo, refused to campaign for Mr Mugabe at the election.

Mr Mugabe is surrounded, however, by a harder-line faction of politicians, military bosses and police chiefs. Mostly unelected, they would lose their jobs in any power-sharing deal. Mr Tsvangirai says he cannot deal with people like Jonathan Moyo, the information minister, or Patrick Chinamasa, the justice minister, “since this very small clique will hang on until the building burns down.”

Talks between the MDC and ZANU's more moderate leaders might, in themselves, foster disunity within the ruling party. Ethnic loyalties, and quarrels between sub-groups, may also become increasingly important as tensions grow.

South Africa's president, Thabo Mbeki, wants to encourage inter-party talks, perhaps in the hope of establishing a “government of national unity” led by ZANU pragmatists. He recently met Mr Mnangagwa and Simba Makoni (a former finance minister who was sacked for suggesting reforms), before calling for Zimbabwe to be readmitted to the Commonwealth. The MDC does not trust Mr Mbeki, however. This week, Mr Tsvangirai accused him of a “nefarious strategy” to subvert international efforts to rein in “Mugabe's violent and illegitimate regime”.

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European diplomacy over Iraq

United in theory, divided in practice

Feb 20th 2003 | BRUSSELS
From The Economist print edition

The European Union's new-found “unity” over Iraq may not last long

Get article background

WHEN the leaders of the 15 members of the European Union assembled in Brussels on February 17th for a special summit about Iraq, there was a strong feeling that the anti-war party was in the ascendant. The weekend before the summit there had been huge demonstrations for peace across western Europe. Some of the biggest turn-outs had been in the capitals of Britain, Spain and Italy, whose leaders have backed the American line on Iraq. And the ripple of applause that greeted Dominique de Villepin, the French foreign minister, when he made his plea for weapons inspections rather than war at the United Nations also was still ringing in the ears of European leaders.

So Tony Blair, José María Aznar and Silvio Berlusconi found themselves out in the cold, did they? No. The joint declaration at the end of the summit was surprisingly tough. It stated that “Iraq has a final opportunity to resolve the crisis peacefully” and endorsed the idea of the use of force as a last resort. The crucial question of timing, however, was left hanging in the air. In a sop to the Franco-German position, the EU insisted on giving the United Nations weapons inspectors “the time and resources the UN Security Council believes that they need.” Then, in a nod to the Spanish-British position, the statement added that “inspections cannot continue indefinitely”. Both sides could claim some satisfaction. But like all such diplomatic compromises, this one is liable to prove fragile under the pressure of events.

Diplomats who followed the private discussions of the European leaders described the atmosphere among them as “tense and frosty”. No sooner had the dinner finished than these tensions emerged. France's Jacques Chirac gave a press conference in which he lambasted sundry central European countries for taking a pro-American line. The next day, Mr Blair riposted with a letter to the leaders of the ten countries, mainly in central Europe, that are due to join the Union in 2004, regretting that an initial invitation to them to attend this EU summit had been withdrawn. The implied slap at France was duly noted in Paris, with the French press accusing Mr Blair of once again breaking ranks with an agreed EU position.

In two camps

The fact is that the EU remains split down the middle. Lined up with the Americans on Iraq are Britain, Italy, Spain, Denmark, Portugal, the Netherlands and Ireland; in the be-more-patient camp are Germany, France, Belgium, Greece, Finland, Sweden and Austria, while Luxembourg, the EU's smallest state, seems paralysed by indecision. Both sides know the realities of world power and the limits of their own. Both have outside resources to call on: the patient governments know that the voters of Europe are strongly on their side; the Atlanticists know that most of the would-be member governments, well aware how they escaped the Soviet grip, are in their camp.

The EU is not the only Brussels-based institution that has split over Iraq. NATO has only just emerged from a bitter three-week argument about how far to go in giving Turkey the defence against Iraq that it had asked for. France, Germany and Belgium last week refused to agree to a package of defensive measures for Turkey that was backed by the other 16 NATO members. Such a package, they argued, would imply that war was inevitable.

In the end, a deal was struck by taking the necessary decisions in NATO's defence planning committee, of which France, by its own long-past choice, is not a member. After intense diplomatic pressure, the Germans and Belgians caved in. But several of the elements of the package of agreements had to be removed to appease them. Ironically, just as a deal was agreed at NATO, it became clear that Turkey was in no undue hurry to allow the United States to use its territory for an invasion of Iraq anyway. In the end, that will probably happen. Meanwhile, as George Robertson, the secretary-general of NATO, acknowledges, the dispute over Turkey has done real damage to the organisation.

The difficulty is that current arguments within Europe are not really about Iraq and weapons of mass destruction. They are about attitudes to the United States and to its pre-eminence. Such differences of opinion are always likely to re-emerge, at some point.

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France and Iraq

L'Europe, c'est moi

Feb 20th 2003 | PARIS
From The Economist print edition

The president is raging, but his rhetoric is calculated—and popular

AP

Self-evident, isn't it?

Get article background

JACQUES CHIRAC, winner of the Nobel Peace Prize? Maybe not, but this week the French president found himself (along with the pope and U2's Bono) officially on the list of candidates, one reward for his opposition to an American-led war on Iraq. A second reward is closer to home: the latest French opinion polls give him sky-high ratings. In one poll, 65% call his attitude “daring”; 77% say “courageous”; and 83% “justified”. Mr Chirac is on a roll.

But he has also poisoned France's relations with many of its allies. British and, still more, American media have raised their tradition of “frog-bashing” to new heights; American politicians talk of boycotting French products and the Paris air-show; and the prime ministers of Britain, Spain and Italy find it hard to hide their exasperation (made worse, in Britain's case, by the participation in this week's Franco-African summit in Paris of Zimbabwe's dictatorial Robert Mugabe).

Such rifts in the transatlantic alliance and within Europe carry obvious risks. Yet at an emergency summit of the European Union on February 17th, Mr Chirac seemed determined to make them worse. Referring to their recent declarations of support for American policy on Iraq, he hinted that France might veto the applications by former communist countries to join the EU. They “have not been very well behaved,” he said, “and have been rather reckless of the danger of aligning themselves too rapidly with the American position.” As to Romania and Bulgaria, whose membership is still to be negotiated, “if they wanted to diminish their chances of joining the EU, they could not have chosen a better way.”

Hmmm. Has Mr Chirac caught an attack of *folie de grandeur*? His tirade against the ex-communist applicants echoes his sharp words at an EU summit last October, when he told off Tony Blair as “badly brought up” for daring to criticise France's addiction to agricultural subsidies. Now it is the Latvians, Estonians, Slovenians and others who are being “childish” in pledging support for America.

Yet the French president's outbursts are not irrational. The “Chirac doctrine” that has emerged since his re-election last year is the Gaullist one of old: Europe must act as a counterweight to America, and France, aided by Germany, must be its directing force. If the candidate countries, all of them present or potential members of NATO, now side with America over Iraq, their presence in the enlarged EU will

lessen French influence and turn the union into a NATO look-alike, Atlanticist by conviction and Anglophone by language.

Yet Mr Chirac's ambitions may fall foul of his tactics. To hold EU enlargement hostage will not worry his voters (few French people have any real enthusiasm for a greater EU), but it will upset many EU governments, not least Germany's.

Nor is his view that the arms inspectors should be given longer in Iraq a simple no to America. It raises the question of how much longer. Talking to *Time* this month, Mr Chirac picked his words. Though it is "probable", he said, that Iraq indeed has biological and chemical weapons, it does not "in the present situation pose a clear and present danger to the region." In contrast, a war would breed more terrorism and "create a large number of little bin Ladens." Hence France's potential veto of a new, war-justifying resolution at the UN. Yet France is not pledged to avoid war come what may: Dominique de Villepin, its foreign minister, was careful to argue in the Security Council that war, while "always the outcome of failure", could not be ruled out if the arms inspections failed.

But just how would Mr Chirac switch from peace to war? If war indeed comes, and France stays out, it risks being damned by many others as the country that split the Atlantic alliance and the EU alike. Yet the more popular Mr Chirac's tactics so far, the harder it would be to join in.

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Germany and Iraq

The tune changes—a bit

Feb 20th 2003 | BERLIN
From The Economist print edition

The government shifts, but the opposition is divided

Get article background

AT LAST Gerhard Schröder has signed up, with the European Union, to the use of force against Iraq as a last resort. Welcome and long overdue, said the conservative opposition—but what a U-turn from a policy that had caused such damage to Germany's reputation and its relations with its American and European partners alike. Edmund Stoiber, Mr Schröder's challenger for the chancellorship last September, likened Mr Schröder's diplomatic bungling to that of Kaiser Wilhelm II, the emperor who led Germany into the first world war.

Mr Schröder denied he had made a U-turn. His rejection of German participation in any war, and his refusal to sign up to any UN resolution permitting one, remain as firm as ever, he says. And, for all the government's abysmal showing in the opinion polls, some 70% of Germans support him on Iraq. On February 15th, 500,000 anti-war demonstrators marched through Berlin. Only 15% of Germans—and only 17% even of conservative voters—feel Germany should join in an Iraq conflict.

So the opposition has a problem: how to demonstrate loyalty to Germany's most important ally, without offending its own voters. The result, so far, has been a mess.

During last summer's election campaign, Mr Stoiber accused Mr Schröder of putting Germany's ties with the United States at risk. Yet he too declared that he did not want Germany to take part in any military “adventures” (his word at the time, not just Mr Schröder's). Now he says Germany must “stand by the side with the United States, even in a military conflict”.

Angela Merkel, leader of the Christian Democratic Union, the big sister of Mr Stoiber's Bavarian-based Christian Social Union, recently also hardened her party's wishy-washy stance. Until now, she had always argued that Germany should stick to the line of its partners in the EU and the United Nations, without spelling out what that line was (forgiveably: there wasn't one). But at a conference in Munich this month, for the first time she backed both military intervention, if peaceful attempts to disarm Iraq failed, and German participation “in accordance with our means”. Had her party been in office, she said, Germany would have joined the eight European countries that put out a declaration supporting American policy.

So far, so plain? No. When Mr Schröder suggested in a parliamentary debate on Iraq last week that the conservatives had now evidently joined President Bush's “coalition of the willing” for a war, the opposition backbenches erupted in outrage, and a red-faced Mrs Merkel angrily accused him of seeking to vilify them as war-mongers. The trouble is that the conservatives themselves are deeply divided. Both parties lay great store by the “Christian” in their names—and the leaders of both the Catholic and the Protestant churches in Germany, like the pope, have come out firmly against any war. Last week, 17 conservative backbenchers in the Bundestag, Germany's lower chamber of parliament, refused to vote for their parties' motions condemning official policy on Iraq. And even among America's most loyal supporters, many have been shocked by the contempt with which people such as Donald Rumsfeld, America's defence secretary, have been treating their country, dismissing it as “old Europe” and lumping it together with the unsavoury regimes of Cuba and Libya.

Till now, Germans have probably been the most pro-American people in Europe. There is still a deep admiration of American values, and immense gratitude for America's role in liberating Germany from the Nazis, building it up after the war, and supporting it over its reunification. Nearly 90% of Germans, say pollsters, believe that the United States will continue to be an important partner. Yet there is growing disquiet, on the right as on the left, about the Bush administration's perceived tendency to divide the

world into “them and us”, and to claim that it alone has right on its side. New polls show 74% of Germans consider the United States has “too much power”; over half think it a greater threat to world peace than Iraq or North Korea.

This week, Atlantik Brücke (Atlantic Bridge), a cross-party organisation for the promotion of transatlantic relations, took a full-page advertisement in American and German newspapers, signed by more than 500 political, business and union leaders, including many opponents of a war with Iraq, to voice their concern over the growing tensions. But Mr Schröder is unlikely to change course. Germany is beginning to look less isolated. While millions demonstrate worldwide against a war, he may be starting to think that the German and French insistence on a peaceful alternative to war may at last be vindicated.

For the moment, his own party is firmly behind him. But he knows it is still a gamble. If the UN Security Council does eventually sanction a war, Germany could be left alone on the sidelines with its international reputation in ruins. Mr Schröder's own future would then be at stake.

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Spain and Iraq

Aznar at bay

Feb 20th 2003 | MADRID
From The Economist print edition

But the prime minister sees light ahead

RIDING on the coat-tails of Uncle Sam has been a hair-raising experience even for Spain's hardened prime minister, José María Aznar. His unquestioning support for President George Bush's readiness to make war on Iraq drew millions of Spaniards out in protest last weekend. And it has left him politically isolated in parliament, and subject to criticism from normally loyal or at least friendly sectors of the media. He won power in 1996, and won again still more handsomely in 2000. Now, for the first time since that second election, opinion polls show the opposition Socialist Party ahead of his own People's Party. These are the worst days of his seven years of office. Why, Spaniards ask, is Mr Aznar risking all on the war?

At times the prime minister and his defence minister, Federico Trillo, have sounded more certain of the existence of Saddam Hussein's weapons of mass destruction and his regime's links to al-Qaeda than is even the Bush administration. Just as Tony Blair's critics have lampooned him as “George Bush's poodle” and accused him of stifling parliamentary debate, so have those of Mr Aznar.

Mr Aznar's argument that by lining up with Mr Bush he would win American support for Spain's fight against Basque terrorists has been mauled by the opposition parties. Is it not immoral, they asked, to support an attack on Iraq to win support for an unrelated domestic matter? One generally pro-government newspaper, *El Mundo*, has pitted itself wholly against the war, and even the centre-right *ABC* has criticised Mr Aznar's dogmatic style, though not his stance. Nearly two-thirds of the People's Party's own voters are opposed to a war without UN authority.

The prime minister feels he has been getting all the pain and none of the glory for his support of Mr Bush. So what is the pay-off he hopes for? Mr Aznar has stated that he intends to be the man who puts an end to Spain's medium-nation status. He wants Spain to come out of the shadow cast by France and Germany within the EU. His central role in drafting the joint letter of eight European leaders in support of Mr Bush underlines that. He hopes that soon Spain will become a member of the G8 group of rich countries. In sum, he hopes, as one adviser puts it, to make his country “one of the few and not one of the many”. Perhaps the weakness of Spain's armed forces and its continued reliance on EU “cohesion” funds precludes that for the moment, and indeed till after his own promised retirement from his job after next year's election. But he can dream.

And though Mr Aznar and his entourage had a bad case of the jitters at the beginning of last week they now think they have turned the corner. This week, consenting at last to a parliamentary discussion—albeit not a formal debate—on the prospect of war, and the EU's new joint position thereon, Mr Aznar told parliament: “We cannot let a no to an Iraq conflict be a yes to Saddam Hussein. Peace is possible, but only his regime has the possibility of disarming and responding to the world's desire for peace.” In the vote, the Socialists abstained—a manoeuvre which, whatever its supposed logic, seldom impresses voters—and Mr Aznar, backed by the Catalan nationalists, won handsomely.

He has also been reassured by a visit from President Bush's brother Jeb, the governor of Florida, who has promised goodies and told Spaniards that Mr Aznar has formed “a very real friendship” with the president. The prime minister is due at the president's ranch this weekend.

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Armenia's presidential vote

Democracy, it's wonderful

Feb 20th 2003 | YEREVAN
From The Economist print edition

Especially for the incumbent—but maybe not quite wonderful enough

AP

Who knows, maybe they'll count it

IT was one of the dirtiest elections even Armenians can remember: more petty fraud, many said, than in the infamous presidential ballot of 1996, in which allegations of ballot-rigging sparked such threatening demonstrations that the then president, Levon Ter-Petrossian, sent tanks onto the streets. Officially the Organisation for Security and Co-operation in Europe, which had sent 200 observers, said the election process culminating in the vote on February 19th "fell short of international standards in several key respects". Privately, one experienced OSCE team member called it "a disaster."

A fairly typical example was the polling station where *The Economist* watched the count. Observers from the opposition parties said that, late in the day, two young men had come in and stuffed a few handfuls of ballot papers into the box before running out again. The papers, they said, had been folded twice in the same direction, instead of lengthwise and then crosswise, as most voters folded them. And sure enough, as the vote-counters plucked the papers from the box one by one, there was a period when an unusually large number were folded lengthwise—and, lo, most of those were for the (since 1998) incumbent president, Robert Kocharian.

He also had the media behind him. One Armenian monitoring organisation counted five times as much television coverage for Mr Kocharian as for all his opponents put together. Early results gave Mr Kocharian 51%, just enough to save him from a run-off with his leading opponent, Stepan Demirchian. Surprise, surprise, murmured cynics. It was just such a "result" that set off the protests in 1996. Yet at the last moment somebody's nerves must have cracked, under a bit of OSCE arm-twisting, maybe. By the afternoon, the election commission was announcing that Mr Kocharian had fallen just short of an absolute majority: he had 49.8%, and must face a run-off after all.

Mr Demirchian's father, Karen, a charismatic former Communist boss, was one of eight leading politicians assassinated in parliament in 1999. The case is murky, and the trial of the killers still drags on. The younger Mr Demirchian has inherited his father's good looks and gravelly voice, which helped him to inherit some sympathy votes too. His closing rally in Yerevan, three days before polling day, was the biggest gathering locals could recall since the collapse of the Soviet Union. Even so, he scored—officially—only 27.7%.

Has he a real chance now? This Mr Demirchian did not, by common consent, inherit much of his father's intellect. Even if he can win in the second round, he would have to build a good team and be a wily operator to make headway against Armenia's entrenched political forces; to say nothing of its hostile neighbours, Azerbaijan and—though the Turks would not put it quite this way—Turkey.

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Cyprus's new president

And now?

Feb 20th 2003 | NICOSIA
From The Economist print edition

Clerides out, Papadopoulos in—and reunification further off than before?

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AP

Ten-finger exercise for Papadopoulos

THE election of Tassos Papadopoulos as president of Cyprus—in practice, the Greek-Cypriot south—comes at a critical moment. On February 26th Kofi Annan is due in Nicosia with a last-ditch revised version of the United Nations plan for reunifying the island. Mr Papadopoulos and his Turkish-Cypriot counterpart, Rauf Denktash, will be given 48 hours to agree a deal. If they cannot, when Cyprus signs its EU accession treaty in Athens in April the prospective EU member will, de facto, be only the Greek-Cypriot part of the island.

Mr Papadopoulos surprised pollsters by winning outright, with 51.5% of the vote in the first round, to oust Glafcos Clerides, the 83-year-old incumbent. He leads the centre-right Democratic Party, but was also backed by the communists—the biggest vote-getters on the island—the socialists and the Greens. A feisty lawyer of 69, as a young man he was in EOKA, the guerrilla group that led the movement for independence from Britain in the 1950s.

He has also been considered the leader of a “rejectionist” faction opposed to compromise with the Turkish Cypriots. But he is trying hard to re-invent himself as a dedicated negotiator for peace. He promises that Turkish Cypriots, isolated and impoverished—not least by an international embargo—in Mr Denktash's self-declared republic in the north, would have a chance to prosper in a re-united island.

Humph, say they. Mr Denktash said flatly that with Mr Papadopoulos in charge in the south “the road to a solution is closed.” So far, Mr Denktash has been the bigger obstacle, refusing to hand the Greek Cypriots all of the 9% of the island's territory called for in the UN plan. But he could perhaps be arm-twisted by Turkey's new government, which is keen to see a real, re-unified Cyprus in the EU.

Many Turkish-Cypriots are keen too. Now the doubts are about Mr Papadopoulos. His communist backers broadly favour a deal; his own supporters want changes—more Greek Cypriots, they say, should to able to return to the actual homes they fled in 1974, as Turkish troops invaded to prevent Cyprus being hijacked into union with Greece. Many who voted for Mr Papadopoulos because of his rejectionist image would opt for the status quo.

But there is a catch. The EU agreed to let Cyprus sign up, even disunited. But actual membership in May 2004 still requires ratification by all EU states. Some might yet cause trouble.

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Charlemagne

Jacques Chirac's Samson option

Feb 20th 2003
From The Economist print edition

France's high-risk diplomacy is in danger of hurting France itself

Get article background

THEY wouldn't do it, would they? They wouldn't be rash enough to push things to the limit and use their veto, gravely undermining an institution they cherish? The French have greatly enjoyed keeping the world guessing about their intentions in the United Nations Security Council. But the UN is not the only place where France is threatening to use a veto. At a European Union summit in Brussels on February 17th, Jacques Chirac, France's president, warned none too subtly that France might still block the enlargement of the EU to take in ten more countries, mainly from central Europe, which are due to join next year. Most diplomats still regard it as a done deal and think it inconceivable that France would really do something as spiteful and destructive as rejecting countries from the old Soviet block. But just as it is a mistake to underestimate France's willingness to confront the United States at the UN, so it would be unwise to ignore the real threat that France now poses to enlargement.

Iraq and the EU's enlargement may look unrelated. In fact, for the French, they are closely linked. France has long cherished the ambition that the EU would one day act as a superpower that could stand up to the United States. It has also long suspected the central Europeans of being a Trojan horse for the Atlantic alliance within the EU. For the French, the Iraq crisis has dramatically illustrated these fears. Here, they argue, are the Americans, clearly acting dangerously, providing Europe with both an opportunity and a duty to block the “hyperpower”. But France's ambition to present a united European front has been undermined by expressions of support for the Americans. First came a letter from eight European countries—five current EU members, plus Poland, Hungary and the Czech Republic, the three biggest members-to-be. Then came a letter from “the Vilnius ten”, a central European and Balkan group which includes five more countries due to join the Union next year.

President Chirac's fury became evident at this week's Eurosummit. With a mixture of arrogance and rudeness that made Donald Rumsfeld, America's abrasive defence secretary, look like Mary Poppins, the French president upbraided the candidate countries for their pro-American statements. The central Europeans, he opined, were “badly brought up”, “childish” and “irresponsible”. They should remember that all the current EU members still have to ratify the treaties of accession to let the newcomers into the club. France, he hinted, could call a referendum on enlargement. The state of public opinion in France, where 18% of the votes were recently cast for a xenophobe for president, suggests that the French might give a resounding no. Though it would be highly unusual for the Union's existing members to vote on letting newcomers in, there is a precedent: France had a referendum on admitting Britain in the 1970s.

The next day Michèle Alliot-Marie, the French defence minister, rammed home her country's message. On a visit to Warsaw, she warned the Poles that their support for America was endangering their chances of joining the EU. The Poles particularly angered France recently by having the temerity to order American F-16 fighter aircraft rather than French Mirages. Alain Duhamel, an influential pro-European commentator, gave an insight into the French establishment's thinking in a recent article in the left-leaning newspaper *Libération* headlined “Europe: stop enlargement”. He gave warning that the dreams of those who want a “European Europe” are in danger of being swamped by new arrivals “fascinated” by the United States: “the Europe of Brussels is encircled by the Europe of Washington.” Mr Duhamel urged the French parliament to refuse to ratify enlargement.

Are such threats for real? Blocking enlargement would cause a severe crisis in the Union. It could tear the club apart, even destroy it. It would enrage many other EU countries, not least France's key ally, Germany, which deems enlargement a strategic and moral imperative. On the other hand, muse some French pundits, the Germans share some French worries about enlargement. Sure, they say, the

Germans might protest at first. But in the long run, might they not fall back into the comfortable French embrace of old? Using Iraq as a pretext for provoking a crisis over enlargement could also be attractive, given that European public opinion is sympathetic to France's anti-war position. And if some EU members—the British and the Nordics, say—were to walk out of the club in disgust if France did indeed veto enlargement? Well, in the view of the real head-bangers in Paris, so much the better.

Bring the European temple down on your own head?

Yet destroying the EU in order to save it (or at least France's vision of it) is so extreme and high-risk an option that it is still hard to envisage France taking that route. It is more probable that Mr Chirac's threats against the candidate countries are driven more directly by Iraq. If America and Britain cannot get a second UN resolution before an attack on Iraq, they may look instead for expressions of support such as the recent letters from central Europeans. Mr Chirac's aim, as he candidly put it at a recent press conference, is to persuade such people to “shut up”.

Such a strategy could backfire. The day after the French president's outburst, the central Europeans were trying to bite their tongues. Peter Medgyessy, the Hungarian prime minister, remarked (in immaculate French), that he was “too well brought up” to respond to Mr Chirac's gibes. But several other central European leaders emphasised their right to think and speak independently. In the longer term, France's strategy is even harder to fathom. If and when the ten newcomers do in the end join the club in May next year, they are hardly likely to feel well-disposed to a French president who has made it clear that he regards them as a bunch of ungrateful and unhousetrained peasants. Mr Chirac's fear that France will lose control of a larger European Union would then risk becoming a self-fulfilling prophecy.

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Tony Blair and the war

Who cares?

Feb 20th 2003
From The Economist print edition

AP

The stakes are higher, but there is no sign of the prime minister flinching

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ANTI-WAR protesters would like to think that their efforts are rocking the government. But nothing of the kind seems to be happening.

It is true that the past few days have included some nasty moments for Tony Blair. One was that Hans Blix did not, as some were expecting, tell the United Nations Security Council on February 14th that he had uncovered new and damning evidence of Iraqi misbehaviour. That stoked public scepticism about the case for war, and helped boost attendance at probably the biggest demonstration in Britain's history, when a million-plus people filled central London on February 15th. An opinion poll by ICM showed the prime minister's popularity plunging, to its lowest since the petrol price revolt in 2000.

But there have been some good bits of news too. One is the outcome of the European Union summit on February 17th, where France started to look just a little isolated, the anti-war camp shrank, and everyone signed up to a fudged communiqué that kept the use of force as an option. On February 20th, two top churchmen, the Anglican archbishop Rowan Williams and his Catholic counterpart, Cardinal Cormac Murphy O'Connor, issued a joint statement saying the alternative to war was not appeasement.

Although the polls show that voters are not keen on a war now, there is still a clear majority for an attack on Iraq that has UN backing. A poll by YouGov showed that 80% of voters thought that the Iraqi leader should be given a deadline to disarm. The ICM poll showed that although Labour's rating has dipped, the party's supporters themselves still believe strongly that Mr Blair is doing a good job overall.

Most important, though, is what is not happening. The cabinet hasn't split and though most Labour MPs, under pressure from party activists, are deeply worried, the prime minister is gaining at least some credit for his sincerity and determination.

It is hard to see public discontent turning into a real threat to Mr Blair any time soon. Critics within his

own party, such as the veteran anti-war campaigner Tam Dalyell, have concentrated their fire on what they claim is his reluctance to consult Parliament. There is no heavyweight figure around whom a challenge to his leadership might coalesce. Nor is there much to worry Mr Blair on the benches opposite. The Liberal Democrat leader, Charles Kennedy, has done well with his carefully maintained scepticism about the war, but he knows that outright opposition once troops are in action would be politically very risky. The Tories, meanwhile, broadly supportive of Mr Blair's stance, are making more headlines with their own private feuds than with anything about Iraq.

For all its numbers, the anti-war movement is not just shallower than it looks, but also more fractured. The speeches at the rally were mostly unimpressive and had a strong whiff of sectarianism and nuttiness. One particularly revealing television clip from that day showed Tony Benn, the grand old man of British left-wingery, berating an Iraqi student who had turned up to support the war. He accused her of being a CIA stooge. That made him look nasty and patronising, and her look brave.

The same arguments are echoed by a small but growing handful of habitually left-wing but independent-minded journalists who have been raising the question of human rights in Iraq—a cause that was once dear to the hearts of many liberal-minded Britons. Nick Cohen, of the *Observer*, says that toppling Saddam should be seen as an “anti-fascist struggle”.

Although regime change has never explicitly been part of the government's case, Mr Blair is now stressing the same argument. War is bad, he told the Labour Party conference in Scotland on the day of the march, but leaving Saddam in power would be even more inhumane. His next move will involve visits to his allies in Spain and Italy. During a stopover at the Vatican, he will show that he gives peaceniks like the pope a respectful hearing.

While the government stands firm, it is hard to see what, in the short term, the anti-war movement can do next. Some left-wing trade unionists talk of striking when the war starts, but that sounds like wishful thinking. There is a small movement in the Labour Party to cut up membership cards in protest at Mr Blair's stance. Given that membership is declining fast that is troubling, but is hardly likely to mean sleepless nights in Downing Street.

While the war is fought with nerves rather than bullets, Mr Blair's position is impregnable. As always with wars, his fate will turn on what happens when the real fighting begins.

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Aviation

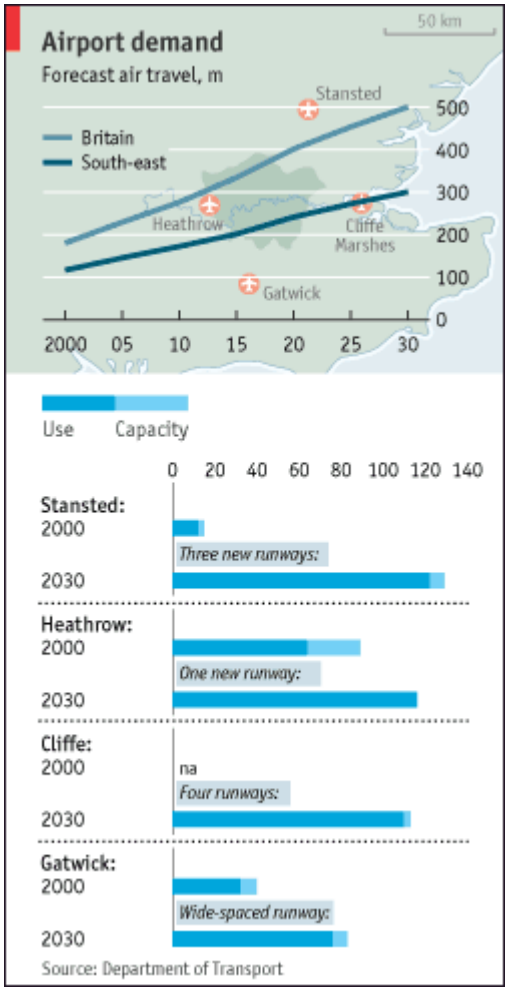
Predict and provoke

Feb 20th 2003
From The Economist print edition

The skies are almost as congested as the roads. Time for a rethink there too?

AS MINISTER for aviation, Chris Mullin learnt, he says, two things: that the demands of the aviation industry are insatiable, and that governments usually give way to them. That reflects the post-war "predict and provide" approach to much of transport policy. Since 1989, when an avalanche of public protest buried an ambitious white paper on road-building, the bulldozers have been held back. But in aviation, the old thinking survives.

Now, as the government prepares to give the go-ahead to at least one, and possibly as many as half a dozen, new airports, the conventional approach is under scrutiny as never before. At least three new runways will be needed in the south-east to meet future demand, according to the government's consultation paper (see map). But the possible sites listed for expansion—Stansted, Heathrow or a new estuarial airport at Cliffe in Kent—are bitterly contested. Thanks to an injunction that forced the government to include Gatwick too, it has extended the consultation process until May; a final decision should come later in the year.



At first glance, the case for new runways appears overwhelming. Aviation contributes £10 billion ($16 billion) to the economy annually and supports, directly or indirectly, more than 700,000 jobs. Government forecasts say that as many as 500m passengers will be using British airports in 2030, nearly three times the current numbers. The strain is particularly acute in the south-east, notably at Heathrow, where runway capacity already falls short of demand. If no new runways are built, the government's airport study for the south-east claims, rather implausibly, that as much as £15 billion a year could be lost. Restricting air travel would result in higher fares, possibly as much as £100 per ticket, by 2030. Turning passengers away from British airports would directly benefit competitors on the continent, the aviation lobby argues.

Yet the case for expansion is less than clear cut. Predictions of passenger demand are based on falling airfares, faster growth by low-cost airlines, and a big hidden subsidy from the taxpayers. Challenge those assumptions and things look very different. A report due next month from the Institute for Public Policy Research, a leftish think-tank, says that if aviation was properly taxed and bore its full environmental costs, no airport expansion would be needed at all.

The tax regime is certainly odd. Aviation fuel is tax-free, a concession worth nearly £6 billion a year; there is no VAT payable on tickets (another £2.4 billion a year); and duty-free shopping chips in a further £400m. The net benefit of this set-up is a subsidy of roughly £40 per passenger per flight—four times more than they pay in tax. If aviation also had to meet its full environmental costs, as the government's 1998 transport white paper suggested, the sums would look different.

Unfortunately, there is no international agreement on the environmental burden imposed by aviation—estimates for the cost of the CO2, nitrogen and sulphur oxides, hydrocarbons, water vapour and other

gunk spewed out by aeroplanes ranges from £1 billion to £6 billion a year. Nor are there any practical plans for making the polluter pay. A Department of Transport study suggests environmental taxes ranging from £3 for an economy fare short-haul flight, say to Berlin, up to £20 on a long-haul flight to San Francisco. But such levels would have little effect. Bodies such as the Royal Commission on Environmental Pollution argue that air travel is so polluting that current rates of growth are simply unsustainable in the long term.

It is not just cost that could make the forecasts wrong. High-speed railways in Japan, France, Germany, Italy and Spain have proved competitive with air for distances of up to 400 miles. Eurostar has already captured 65% of the market to Paris and 45% to Brussels. This is good news for greens, because it is during take-off and the initial climb that planes burn the most fuel. Short flights are therefore disproportionately polluting—with around twice the external environmental costs of rail, by some estimates.

Another weakness in the aviation industry's case is that a fifth of all passengers using London's airports each year are simply transferring from one plane to another. This number rose from 3.5m in 1992 to 21.5m in 2000, and could reach 60m by 2030, according to the official forecasts. That clearly benefits the airports and airlines. How the country gains, though, is less clear. Connecting passengers pay no passenger duty, and spend little money during their stop-overs. Fewer transit passengers might in theory reduce the number of destinations on offer, but London has by far the biggest range in the world anyway, so a dent would have to be big to make a real difference.

In short, the gap between commercial benefits and environmental costs is narrower than ministers have admitted. To persuade voters that a big expansion is needed, the aviation white paper later this year will need some pretty compelling arguments.

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Road pricing

Ken leads the charge

Feb 20th 2003
From The Economist print edition

London's congestion fee is defying its many critics

BY FAR the loudest noise in London this week was not traffic but critics of the congestion charge in thunderous retreat. Despite forecasts of chaos, the capital's £5-a-day ($8) levy had a surprisingly smooth start. Traffic was a third less in the inner-city charge area and journey times fell by as much as a half. This was more than predicted, even allowing for the school half-term holiday.

Ministers are reconsidering their scepticism. The transport secretary, Alistair Darling, is now expected to publish a consultation document that will look at charging for both cities and motorways. The mayor of London, Ken Livingstone, even received a congratulatory call from the minister of transport, John Spellar, who previously sought to scotch the scheme.

New York, Tokyo, Milan and other cities are watching closely to see how the scheme settles down, and how Londoners' reaction develops. Some technical problems are already emerging. More than 10,000 drivers failed to pay the charge on the first day, five times higher than predicted. Some may have a plausible excuse. The two chief methods of payment, by website and call centre, both experienced hiccups. Though the mayor denies it, officials concede privately that hard cases will probably get a sympathetic hearing until the glitches are fixed.

Another difficulty is increased traffic elsewhere. The mayor is already talking of expanding the charged area westwards if he is re-elected.

For the moment, though, his opponents are floundering. Steven Norris, the Conservatives' mayoral candidate, still claims he will scrap the scheme. But this week, he acknowledged that Mr Livingstone just might be on course for “a considerable victory”.

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GM foods

Ripe for discussion

Feb 20th 2003
From The Economist print edition

Labour's environment minister has broken ranks on GM food

MUTANT species behaving in uncontrollable ways, wrecking a delicate balance. That is how the green lobby sees genetically modified (GM) crops. But roughly the same description applies to the situation developing inside the government, where the environment minister, Michael Meacher, has torn up the official line on the issue. In a new interview in the *Ecologist*, a green magazine, he casts strong doubt on the safety of GM foods, and describes GM as “not necessary”.

That contrasts sharply with the government's cautious “wait-and-see” position, and in particular Tony Blair's broadly pro-science stance. Last year the prime minister said there was “no serious evidence of health risks” in GM food.

It is not the first bit of unauthorised greenery by the idiosyncratic Mr Meacher, who enjoys a precarious governmental position as a semi-tolerated environmental dissident. In August, Mr Blair's office even left him out of the official delegation to a big jamboree on green development in Johannesburg. It backed down only when environmental groups said they would pay his air fare there themselves. Mr Meacher described himself then as a “lone voice in the wilderness” for the green cause in Whitehall.

But the new wobble comes as the government is deciding whether to lift the current moratorium on GM food in Britain and allow its commercialisation. Since the furore over “Frankenstein” foods erupted in 1998, the authorities have commissioned several large studies to assess the scientific and economic evidence, as well as popular opinion, for or against a change in policy.

One big question is biodiversity; the effect of GM crops on butterflies, weeds and bugs. Three years ago, the government authorised more than 180 field trials across the country to compare the effects of one particular type of genetic modification—herbicide-resistance—in sugar beet, maize and oilseed rape. After £5m-worth of experiments, the results are due for publication by the Royal Society in July. A separate science review, drawing on international evidence about broader questions such as the impact on the environment and food safety, will deliver a final report in the early autumn.

A third investigation is an economic assessment of the costs and benefits to domestic farmers, food processors, retailers and consumers, as well as to developing countries, of Britain's adopting or rejecting GM; the Cabinet Office, which is responsible for this work, is scheduled to release its findings in June.

One useful bit of evidence that this could include is a paper published this week by Mike May, of Broom's Barn Research Station in Suffolk, about gene technology in the sugar beet industry. Herbicide-resistant GM sugar beet could, he says, save British farmers £23m a year, mostly through reduced use of agrochemicals. That would, on paper at any rate, both boost profits and help the environment.

What effect such evidence may have on the population's scepticism is another question. The government has also launched the pompously named GM Public Debate, charged with stimulating discussion beyond the narrow circle of activists and experts. This is scheduled to launch a series of local and national meetings in May, culminating in a report in September. Many of the questions which arise from these public sessions will be fed back to the other inquiries for answers.

The debate is in fact a low-budget affair, and it will have its work cut out to raise much interest. Studies by Corr Willbourn, a market research firm, show that GM lags behind more pressing public concerns such as war with Iraq or football. For all the acres of newsprint devoted to GM at the height of the frenzy, Corr Willbourn found that most of the people surveyed confessed both to knowing very little about the issue, and also to doubting that the government would take much notice of outsiders' views.

But those dealing with the issue say that public attitudes have matured somewhat from the initial polemics, and that the pile of new evidence will get a fair hearing in the coming months. John Pidgeon, director of Broom's Barn Research Station, speaks of an “outbreak of common sense”. That would be worth cultivating—not least inside the greener nooks of the government.

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City scandal

Sex (ism) in the City

Feb 20th 2003
From The Economist print edition

Clara Furse, head of the London Stock Exchange, deserves better than this

CLARA FURSE is blonde, a woman and a foreigner. She is also one of the best-paid and most prominent administrators in British finance. As chief executive of the London Stock Exchange (LSE) her job is the City's equivalent of managing the national football team.

Until now the Canadian-Dutch Ms Furse has managed to keep attention off her personal attributes and on her professional achievements. Her three immediate predecessors resigned after ill-judged adventures in technology and strategy. Under her steady and cautious stewardship, the LSE has done better, although critics are still waiting for a big deal that would reinforce the exchange's position as Europe's top bourse.

In the past few days, though, serious coverage of the exchange's affairs have given way to a malicious whispering campaign about Ms Furse. Had she been a married man with three children, such stories, true or false, would have barely raised an eyebrow, let alone prompted prurient stories in the tabloid press.

Although many people working in the City have heard the rumours, no media outlet has reported them directly. The LSE found it necessary to issue an unprecedented statement on February 17th threatening legal action against anyone who did so. It also produced affidavits from the people supposedly involved, denying the story. But that just gave the media even more grounds for reporting the gossip's existence—almost as damaging as dishing the dirt directly. Not like this article, of course.

Ms Furse has made no comment. Don Cruickshank, the chairman of the LSE, denounced the “outrageous, totally unfounded, offensive slurs”. The gossip-mongering, he said, is likely to be an example of sexism in the city, rather than anything related to the LSE itself.

Whatever the source of the rumours, and regardless of whether it is misogyny, xenophobia, lechery, jealousy or boredom that provoked them, Ms Furse has plenty of real work to be getting on with.

Her biggest disappointment so far was failing to buy LIFFE, London's derivatives exchange. Paris-based Euronext acquired it instead. A link with NASDAQ, America's troubled tech-heavy exchange, also fell through.

Since then she has been advancing in smaller steps. On December 9th last year the LSE announced a new derivatives exchange called EDX London. This is a joint venture with OM Gruppen of Stockholm.

But her biggest challenge is to make sure that the LSE is a senior rather than a junior partner in an alliance either with Euronext, or with Deutsche Börse, the other major exchange in Euroland. That should mean more headlines, but less salacious and more informative.

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Public services

Caved in

Feb 20th 2003
From The Economist print edition

A government concession makes public-service reform harder

FOR all his firmness on foreign affairs, Tony Blair is beating an ignominious retreat on an important home front: making public services work harder and better.

The talk used to be tough. When launching Labour's manifesto in the 2001 election, Mr Blair said that “no barriers, no dogma, no vested interests” should block public-service reform. But the trade unions have now scored a notable victory in curbing employers' freedom to manage their workforce in contracted-out services in local government.

The unions' *bête noire* has been what they term a “two-tier workforce”. The arrangement so far has been that when a private contractor took over a public service, it kept existing employees on the same pay and conditions. But the outside firm was allowed to hire new employees on different terms.

That alarmed the powerful public-sector trade unions. They loathe the private finance initiative (PFI), which uses the private sector to finance, build and service hospitals, schools, prisons and the like. That, they say, enables skinflint employers to pay poverty wages to the weakest people in the land. Their case has been bolstered by “Hard Work”, a new book by Polly Toynbee, a columnist on the *Guardian*, which documents in depressing detail the miserable working lives of those at the bottom of the job ladder.

Under a draft code of practice issued last summer, new recruits were to be offered “broadly comparable” terms to previous public-sector employees, taking into account local labour-market conditions. This still gave private contractors some freedom. Now the reference to local labour markets has been excised. Instead the new code says terms must be “no less favourable”. Three small words—but a giant climb-down.

Employers argue that they need freedom to make services not just cheaper, but better and more flexible. Now they are as outraged as the unions are exultant. Norman Rose, head of the Business Services Association, which represents many private contractors, says: “Our costs will go up and outsourcing will become more expensive to the public sector.” Mr Rose calculates that the concession could add a further 10-20% to payroll costs as employers have to pay higher public-sector wages rather than market rates.

Private employers may also face new legal difficulties, since the effect of the new code will be to create another two-tier workforce. Those hired to do public-service work may enjoy better terms than those doing similar private-sector jobs. The latter category could challenge this, expensively, in court.

The government has put a brave face on its retreat, arguing that it will force contractors to compete on quality of service rather than low wages. But if the private sector has performed poorly in some contracts, the real culprit is public-sector managers who fail to nail down what they want.

In fact, fixing the job market like this will not necessarily bring any improvement—and could well make public services worse. More and more, they need to be provided in flexible ways—involving, for example, more work outside standard hours. This can be difficult or costly to achieve under existing union agreements. Mandy Wright, of the local government employers' organisation, says her members want to be fair to staff, but are concerned that the new regime will lead to “rigidity” and slow down modernisation.

The code now seems certain to spread from new contracts in local government to the rest of the public sector. That is certainly what union leaders want. If this happens, the government will find it even harder to rebut one of the most damning charges about its enthusiasm for PFI: that the whole thing is mainly a

way to fiddle costly investment projects off its books, rather than a genuine attempt to give the taxpayers a better deal.

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Prison suicides

Death sentences

Feb 20th 2003
From The Economist print edition

As the prisons bulge, more and more inmates are killing themselves

ONE of the most disturbing features of Britain's rising prison population is a rise in the number of prisoners taking their own lives. Last year 94 inmates of prisons in England and Wales committed suicide, up from 67 the year before. The figure so far this year is already 18. No one has a simple explanation for this trend, still less a simple solution.

Last year, as in earlier years, the age-group with the most suicides was that of 30-39-year-olds (24 in the first ten months of 2002). Among those in their 20s, 21 took their lives in the same period, and among those in their 40s, the number was 14. Eight people aged 18-20 killed themselves; one was younger. The number of women was disproportionately high: they represented 11% of the suicides (to October), but only 6% of the prison population.

Why were these people in prison? Among those who took their lives in 2002, the commonest type of offence for which they were being punished was violence against other people, followed by robbery and burglary. But only two-fifths of those who died had been tried and sentenced; the others were on remand, awaiting trial.

The characteristics of those who killed themselves in 2002 were much the same as in previous years, with one exception: the proportion who died during their first month inside was even higher than usual. This is a time of particular vulnerability, when prisoners are confronted with what lies in store for them, and have yet to establish relations either with other prisoners or with staff.

If they are in a prison far from home, they may feel especially isolated. Of the 70,000 or so prisoners in England and Wales last October, 27,500 were held over 50 miles away from home and 12,500 were over 100 miles away. Such distances make it difficult for family or friends to visit.

The Prison Service is acutely aware of, and demoralised by, the rising number of suicides. Many governors are doing their best: well-run prisons, for example, now have “first-night” centres to reduce the risk of suicide on arrival. But prison staff are sorely overstretched, as more and more people are sent to jail (the total is expected to rise to between 91,000 and 110,000 by 2009, up from 45,000 in 1991). Overworked warders do not have time to identify and give support to those contemplating suicide. The Samaritans, a charity that helps the suicidal, trains prisoners in many jails to act as “listeners”, but it is hard to reach some new arrivals in time.

Many people in prison have psychiatric problems. A recent survey found that 78% of men on remand, 64% of those sentenced and 50% of all women prisoners in the sample had a personality disorder. A significant proportion, highest among women, suffered from mental illness. Moreover, many prisoners (46% of men on remand, for instance) had considered suicide, and quite a few (27% of men on remand) had tried it. Other forms of self-harm are common.

Alison Liebling, a criminologist at Cambridge University, says those who kill themselves fall into three main groups. First is prisoners facing long sentences, especially those convicted of assaulting a family member. Second is those with psychiatric problems. Third is the “poor copers”—people returning to prison for a second or third time, and suddenly confronted with the mess they have made of their lives. Often addicted to drugs, they tend to be unable to cope with life either inside prison or outside. Reducing suicides among prisoners is difficult anyway. But the sheer numbers locked up make the task even harder. The mounting deaths are one of the grimmest stains on the government's penal policy.

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Conservative wars

May be nasty

Feb 20th 2003
From The Economist print edition

Tory tantrums continue, damagingly

ONLY seven months into the job, and the Conservative Party chairman, Theresa May, is hanging out to dry. Aides of the leader, Iain Duncan Smith, who appointed her, now say that he has lost confidence in the management of the party.

The new row follows the leader's sacking of the party's chief executive, Mark MacGregor, and the director of research, Rick Nye. Both are associated with the modernising wing of the party, which supports Michael Portillo, Mr Duncan Smith's defeated rival.

People are very cross. The party's 17-member board was not consulted. Some members say that the appointment as chief executive of Barry Legg, who is also Mr Duncan Smith's chief of staff, is “unconstitutional”.

What happens next? Mrs May wants to stick it out. But the Tory faithful have not forgiven her for telling their conference last year that some voters saw them as “the nasty party”. A possible replacement is John Redwood, a clever right-winger. But voters find him creepy.

The real point of the row is that Mr Duncan Smith wants unquestioned support for his return to more traditional Tory issues such as freedom, order and low taxation. His predecessor, William Hague, made the same rightwards lurch at roughly the same stage of his leadership. But look what happened to him.

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Bagehot

The other referendum

Feb 20th 2003 | BRUSSELS
From The Economist print edition

For a while, “Europe” has been the dog that hasn't barked. That is about to change

Get article background

IT IS easy to see why Europe has been the great unmentionable of British politics. After clinging to the belief that “saving the pound” was their trump card, the Conservatives painfully discovered at the last election that it was no such thing. It was just a reminder that their party was still obsessed by things that do not touch the lives of ordinary people. Even the anti-Maastricht rebel, Iain Duncan Smith, could see that until Tony Blair plucked up the courage to hold a referendum on the euro, there wasn't a lot to talk about.

For the government, it has been much the same. Whenever Mr Blair expresses his devotion for Europe and the euro, he merely awakens speculation about the troubled relationship with his veto-wielding chancellor. As the likelihood recedes of anything other than a “not yet” verdict from the Treasury's five economic tests later this year, political interest has waned further. The damning report that Gordon Brown delivered to his fellow finance ministers this week, on the failure of the euro-zone countries to deliver on the economic reforms they agreed to in Lisbon three years ago, seemed just confirmation of what is known already.

And if the prospect of Britain joining the euro seems as distant as ever, so too, after the last couple of weeks, does that other touchstone of European integration, a common foreign and security policy. While Monday's summit found a watered-down form of words to allow a joint statement on Iraq, President Jacques Chirac's ill-judged railing against the central European accession countries for their infantile failure to back France's line told the real story.

Given Mr Brown's apparent determination to resist the euro and Mr Blair's deeply-held conviction that at times of crisis Britain's place is at America's side, a casual observer might therefore conclude that this is a government that has given up on Europe.

Not a bit of it. The government, with Mr Blair in the vanguard, has been eager to demonstrate its Euro-credentials by taking a positive approach to another project that may turn out to be as important as the single currency. Set up a year ago to devise a new constitutional framework for coping with a greatly enlarged union, the European Convention, under the chairmanship of Valéry Giscard d'Estaing, a very grand and now rather elderly former French president, is in the final stages of drawing up a constitution for the new Europe.

Instead of the kind of foot-dragging and nit-picking that normally characterises the British approach to anything overtly integrationist, Mr Blair has expressed confidence that a constitution that both strengthens the institutions of Europe and defines what the EU can and cannot do in its relationship with member states (termed, in numbing Euro-speak, “exclusive and shared competences”) is strongly in Britain's interest.

He also claims that the constitution will safeguard “subsidiarity” (the idea that decisions should always be made at the most local level practicable) by giving national parliaments early-warning rights. This, he hopes, will calm British fears that the accretion of power by Brussels is an unstoppable ratchet. A couple of weeks ago, the draft articles forming the first part of the constitution were published. Although the dreaded “f-word” (federal) had crept into the preamble, the exclusion of any reference to “an ever closer union” was taken as evidence of effective British influence.

Shall we take a vote?

If the prime minister is right about the fairly benign direction of events, he will have little to fear when the final draft is presented to an inter-governmental conference for approval later this year or in early 2004. But that is not quite how things are seen from within the convention itself. In the first place, while it is true that nearly all the “competences” ascribed to the EU in the draft articles already exist in old treaties, gathering them together in one document is a powerful reminder of how pervasive the union already is.

For the members of the convention, the vast majority of whom are passionate integrationists, this is a splendid affirmation. But in Britain, where successive governments have downplayed the extent of the integrationist march, it is likely to prove shocking. In particular, unless the long list of shared competences covering almost every aspect of social and economic life is defined tightly in part two of the constitution, Mr Blair will be in quite a lot of trouble.

For the Tories, this is a rare opportunity. It should not be too difficult to paint the constitution in luridly expansionist colours. Once there is some resolution of the Iraq crisis, their campaign for a referendum before Parliament ratifies the constitution could well gain momentum. Unlike the euro, this is an issue that the government cannot just kick into touch. Most of the press will back a referendum. So, most likely, will the Liberal Democrats, albeit for different reasons. Enthusiasts in the convention are also increasingly keen on holding pan-European referendums. In some countries, referendums are unconstitutional, but in Britain there could be no such objection.

Could Mr Blair win such a vote when he seems to have no such confidence in winning the desired result on the euro? Perhaps, but only for one very scary reason. Because all the existing treaties will be swept up into the new constitution, it is argued that once the constitution comes into being, the old treaties disappear. Consequently, Mr Giscard d'Estaing has suggested, a vote against the constitution is, *de facto*, a vote to leave the union altogether. The British government will do its utmost to keep this genie well in its bottle, but the possibility can no longer be entirely discounted, even if it is one that the beleaguered Mr Blair would certainly prefer not to contemplate.

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Make or break

Feb 20th 2003
From The Economist print edition

Reuters

Under its new leader, Luiz Inácio Lula da Silva, Brazil could take a leap into prosperity—or slide back towards poverty, says Peter Collins. Which will it be?

Get article background

WHY has the United States prospered and Brazil has not? Both are giant countries, each dominating its half of the Americas, each amply endowed with people, land and natural resources. Each has remained united, with a strong sense of nationhood, after gaining independence from former colonial masters in Europe. But whereas the United States has become the world's economic superpower, its South American sibling is a social and economic under-achiever, the eternal “country of the future” (as it calls itself ironically) whose future never arrives.

Brazilians have tortured themselves with this comparison for decades (see article). Some of the country's thinkers blame their compatriots' misplaced faith in Messiah figures who will come and perform miracles, and contrast this unfavourably with the Americans' ability to organise themselves and work together to build their nation. Indeed, judging by the adulation accorded to Luiz Inácio Lula da Silva since being elected president in October, some Brazilians seem to think that he is the long-awaited Messiah. However, Lula, as 176m Brazilians simply call him (as will this survey), realises that he cannot work miracles alone. He aims to strike an unprecedented “social pact” with all levels of society, which will enable Brazilians as a whole to take a leap into rich-world standards of prosperity, justice and equality, striving together to create “the nation we have always dreamed of”, as he said in his inaugural speech last month.

Exchange rates
Reais, February 10th 2003

$1=	3.59	€1=	3.86
¥100=	2.96	£1=	5.84

The gap between Brazilians' dreams and their reality is enormous. Although by international definitions Brazil is a middle-income rather than a poor country, its glaringly unequal income distribution means that the poorest 50% account for 10% of national income—and so do the richest 1%. Brazil's educational performance has, until very recently, been dismal. Despite recent improvements in environmental health standards, 19% of households still lack running water. Poor communities on the peripheries of Brazil's cities suffer from a plague of violent crimes.

Lula won the election, as oppositions usually do, by criticising the then government for incompetence and inaction and by promising drastic policy changes to bring about rapid improvements. However, he also

abandoned much of the radicalism that lost him the three previous presidential elections. He stopped calling for Brazil to break with the International Monetary Fund and its economic strictures and for the country's debts to be “renegotiated”. Two months before polling day, he nodded his approval of a $30 billion loan from the Fund that committed him not just to keeping the strict financial targets of his predecessor, Fernando Henrique Cardoso, but to tightening them, as he has now done.

Lula's election propaganda constantly harped on about the need for *mudança* (change), and once elected he claimed that he would begin rebuilding Brazil “starting from scratch”. In fact, though, the best prospect of success for the new government lies in continuity. Brazil's frequent political ruptures since independence from Portugal in 1822 led to a lack of follow-through in pursuing public policies that has cost the country dear, but Mr Cardoso, Brazil's longest-serving democratic president, made a good start on overcoming such debilitating short-termism. This survey will argue that, far from starting from scratch, Lula should build on Mr Cardoso's achievements by continuing to pursue many of his predecessor's best policies—especially in welfare, education and health—and to press on with reforms that Mr Cardoso's government started in areas ranging from pensions to policing.

To get an idea of the benefits of continuity, contrast the fortunes of education and justice in Brazil during Mr Cardoso's term of office. In the education ministry, the same minister, Paulo Souza, was in charge for eight years, during which time Brazil achieved near-universal primary schooling for the first time in its history, and a surge in enrolments to secondary and university education. By contrast, during his eight years in office Mr Cardoso presided over a succession of no fewer than nine justice ministers, none of whom made his mark in the job. Murder, armed robbery and other violent crimes continued at shockingly high rates, aided and abetted by a still inefficient and corruption-riddled police and judiciary.

No time to lose

Even if Lula manages to get re-elected (as Mr Cardoso did) in 2006, to give him an eight-year mandate, the maximum allowed under the constitution, he will have little enough time to achieve progress on the scale he is promising. But because of Brazil's precarious financial situation, in reality he has a much shorter period in which to achieve visible results. The government has debts of around $250 billion, or 56% of Brazil's GDP. Much of it is short-term and needs constant rolling over. Most of the debt is tied either to short-term interest rates or to the *real*'s value against the dollar, both of which are strongly affected by investors' fears that Brazil might default on its debts. If those fears increase, the government's financing costs will rise steeply. The risk is that a default might become a self-fulfilling prophecy.

That is the way things seemed to be heading in the middle of last year, as investors fretted about the growing likelihood of Lula beating José Serra, Mr Cardoso's lacklustre candidate. Was the recent move to the centre by Lula and his Workers' Party (PT) genuine, or would they return to their old radical form straight after the election? And even if they did not, would Lula, a man without any significant administrative experience, really be capable of governing such a large and diverse country? Or would he turn out to be like Fernando de la Rua, who in late 2001 was forced to quit as Argentina's president, leaving behind a bankrupt government and an imploding economy? Fears of another Argentina caused the *real* and Brazil's bonds to plunge to levels that suggested the country was heading for default within months. Only when the IMF stepped in with a large loan package last August did the markets recover.

After Lula's victory in last October's election, the gradual recovery of the *real* and Brazilian bonds continued. The markets were cheered by sensible-sounding pronouncements from the new president's economics team, and by the appointment of some respected business and financial figures to key government jobs. But the situation remains fragile. If investors conclude that not enough is being done to avoid a default, they will bring one about in their stampede to avoid being caught. On the other hand, if in the coming months Lula's government can convince investors that it is putting the public finances on a sustainable footing, it will be able to cut interest rates and stoke up economic growth, thereby making a default much less likely.

It is now possible to foresee two drastically different outcomes for Brazil in the near future. The dream scenario is that Lula will be able to use his popularity to push through controversial reforms that will banish the markets' fears of an imminent default. The resulting improvement in the economy will keep the public on his side, and the government's improving finances will provide him with the money to make the big social advances he has promised. Congressmen, mindful of public and media opinion, would feel obliged to collaborate with the president. As long as Lula remains popular, his main opponents—Mr Cardoso's centre-right Social Democrats and their biggest partner in his former coalition, the catch-all Brazilian Democratic Movement—are more likely to keep their promise to be a principled opposition that will back him on reforms vital to the national interest. They might even be persuaded to join his government, giving him a majority in Congress.

The optimists (of whom Brazil is never short) reckon it may be no bad thing that many of the vested interests Lula must overcome are on his own side. Who better than he to persuade unionised workers that they have to make sacrifices? And given his background, at least he did not owe his election to Brazil's avaricious conservative elites, so he will be less beholden to them—unlike Mr Cardoso, who continually had to buy them off.

But a nightmare scenario is also possible in which Brazil follows its southern neighbour, Argentina, into default and economic slump, resulting in rising poverty, crime and unrest. Pessimists say that although Lula and his team are now making the right noises, they will be unable to deliver. If Mr Cardoso, with his big congressional majority, could not complete his reforms of pensions, the tax system, the labour laws, policing and justice, what chance has Lula with his minority government? He cannot even rely on the

support of his own party, which still contains many unreformed radicals.

Lula's campaign material portrayed the former union boss as a “great negotiator” who will sit everyone around the table, persuade all sides to make sacrifices and reach a national consensus to push through reforms. He hopes to achieve this through various grandly titled talking-shops, such as the Council of Economic and Social Development and the National Labour Forum, with representatives from different sectors of society. The danger is that while Lula waits for results he will lose his initial momentum. If the markets lose patience with him and a renewed financial crisis undermines his popular support, Congress may be less willing to support unpopular but necessary reforms.

Indeed, if Lula starts to lose force, the representatives of various vested interests in Congress may seize the opportunity to try to undo some of Mr Cardoso's reforms. Already, some state governors (who often have a lot of influence in Brasília) are pressing for a relaxation of Mr Cardoso's fiscal-responsibility law, which put an end to the spending excesses of local government. If they succeed, the nightmare scenario of Brazil unravelling before Lula's eyes will come a step closer.

For now, either triumph or tragedy seems possible. Much rests on Lula himself, a man whose rise from shoe-shine boy to strike leader to president of one of the world's largest democracies has demonstrated remarkable personal achievement—but who remains an unknown quantity. His first and biggest challenge will be to get the economy right.

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Paradise lost

Feb 20th 2003
From The Economist print edition

Why isn't Brazil rich like America?

“IF WE had been colonised by the English and not the Portuguese, Brazil would be rich like America.” This is a well-worn belief among Brazilians, who have little admiration for their former colonial masters. Some claim they were taught at school that the English gave America their work ethic, sense of citizenship, efficient Anglo-Saxon legal system and of course the English language, whereas the Portuguese exploiters lumbered Brazil with their bureaucracy, their inefficient Napoleonic law code and a language no one wants to speak.

Many Brazilian writers have pursued such arguments, including Vianna Moog, whose 1955 classic, “Bandeirantes e Pioneiros”, is now in its 19th edition. Rather like the Frenchman Alexis de Tocqueville before him, Moog, a Brazilian of German extraction, visited America to study its success and came away impressed with its self-governing ability, its sense of public duty and its notion of the common good. He noted that these values arrived with the first colonisers, written into the “compact” that those on board the *Mayflower* swore to uphold. By contrast, the *bandeirantes*, the Portuguese pioneers who opened up Brazil, came only to exploit its riches and arrived “completely unprovided with economic virtues, public spirit and political self-determination.” As Sérgio Buarque de Holanda, another influential writer on the subject, put it: the English pioneers went to America to build a paradise, whereas the Portuguese went to Brazil to find and enjoy a ready-made paradise.

José de Carvalho, a Rio-based historian, traces Brazil's under-achievement back to the pre-colonial Portuguese cult of King Sebastian, who died fighting the Moors and whose followers believed he would return one day and make Portugal great. This fed into Luso-Brazilian culture, says Mr Carvalho, as the idea that: “We are destined for greatness but can just sit back and wait for a Messiah figure to come along and achieve it for us.” The popular adulation of President Lula since his election suggests that Sebastianism lives on. Last month, when Lula took 29 of his top officials to the *favelas* (shanty-towns) of Recife, he was greeted with placards reading: “Lula, only you can save us,” and “You are the man that we asked God to send.”

Lula's education minister, Cristovam Buarque, points out that, whereas America has “taken education seriously since the *Mayflower*”, Brazil did not get its first university until 1922. Another cause of Brazil's inequalities, says Mr Buarque, is the way Brazil's land was carved up between a few big landlords, whereas America distributed its land in small pieces. Yet another is Brazil's tradition of dictatorship, from which it last emerged only 18 years ago, compared with America's centuries of unbroken democracy.

Eduardo Giannetti, an economist and philosopher, has another explanation: in part, he says, Brazil did not become America because “It didn't want to. It was not as a nation prepared to sacrifice everything for economic progress, as America was. Perhaps it is our cultural choice, rather than a failing, that we are not prepared to sacrifice present well-being for future prosperity.”

There may be something in all these explanations. But whatever the reasons for Brazil's underperformance, President Lula's job is to convince his countrymen not to expect him to work miracles, but to join him in a modern-day *Mayflower* compact to work for a more equal, more just, more educated and more prosperous country.

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Fixing the finances

Feb 20th 2003
From The Economist print edition

There is no way round painful reforms to make Brazil's debts sustainable and speed up growth

FOR the past year the pundits have been arguing over whether Brazil is bound to follow Argentina into default. Even after the IMF stepped in with a $30 billion loan last August, some remained convinced that Brazil's public-debt burden, which almost doubled during Mr Cardoso's presidency, to 56% of GDP, had become unsustainable, and that sooner or later the country would have to “restructure”, willingly or otherwise. Others maintained that the country's twin deficits were well under control, with the government consistently running primary surpluses (before interest payments) and the current-account gap shrinking, thanks to a plunge in the *real*, all of which made a default seem a lot less likely.

John Williamson of the Institute for International Economics in Washington, DC, was one of several economists to crunch the numbers and conclude that a default by Brazil is neither inevitable nor impossible, but will depend largely on investors' expectations. Since most public debt is linked either to short-term interest rates or to the *real*'s exchange rate, Mr Williamson reckoned that, unless these recovered, the debt burden would continue to rise. Investors would take fright and the *real* would plunge further. Attempts to shore it up by pushing interest rates even higher would merely hasten the end.

The no-default camp says there is a way out of this. Most of the public debt is denominated in *reais* (including some that is dollar-indexed but pays out in local currency), so in a tight spot the government could just print more *reais* to repay any debt it could not roll over. The trouble is that this would crank up inflation, which disproportionately hurts the poorest. Would Brazil's first left-wing president really rather default on the poor than on the rich investors in government bonds?

Even if he did, printing money to keep repaying the domestic debt might not avoid financial collapse. The government's foreign-currency-denominated debt, although a minority of the total, is significant, amounting to about $82 billion of the public debt of $250 billion, and Brazilian firms have foreign-currency debts of about $96 billion. Brazil as a whole is already using 91% of its export earnings to service its foreign debt. If foreign banks called in their credit lines, Brazil would soon run out of foreign currency to keep servicing its overseas debt and thus go bust by another means. That is why, when Antônio Palocci was chosen as Lula's finance minister, he went straight off to America to beg the big banks to keep their credit lines open.

However, if investors become convinced that the government has got its finances under control, the *real* will recover and interest rates will fall, making the cost of servicing the debt more bearable. Lower interest rates, and an increased willingness by both foreign and domestic banks to lend, would boost the economy. An improved domestic outlook would encourage multinationals to restart their stalled investment programmes in Brazil, further boosting growth. Since the debt-GDP ratio depends on the trajectory of GDP as well as that of the debt, any boost to growth would bring a further improvement in Brazil's debt ratio which would reassure investors. All the government has to do is persuade investors that everything is going to be fine, and it will be. Lula, literally, has to pull off a confidence trick.

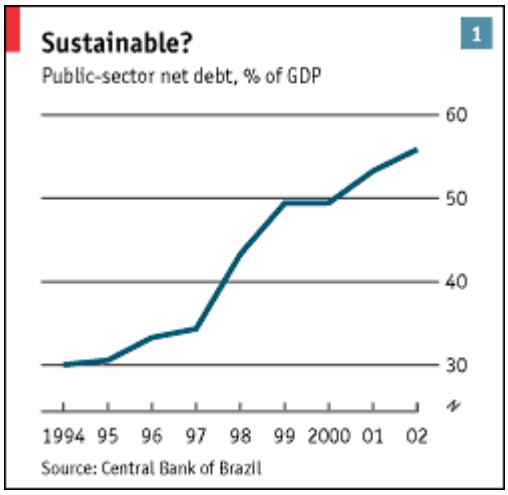
In an attempt to convince investors that its conversion to fiscal rectitude is genuine, the government this month announced a rise in its target for the primary surplus (ie, before debt service) from 3.75% to 4.25% of GDP. The most obvious way for a left-wing government to achieve the new target might be to raise taxes, but taxation in Brazil is already high: 36% of GDP, higher than in America. Raising it further could be counterproductive, because it would encourage even more evasion than now, and perhaps even reduce revenue rather than increase it.

The hard reality

The alternative is spending cuts—not a welcome idea when you have just been elected on a manifesto

chock-full of expensive promises to reduce poverty, improve health, education and housing, invest more in infrastructure and provide more credit to boost growth. However, in the very short term it may be the only option. To scrape together money for his flagship social project, *Fome Zero* (Zero Hunger, an ambitious plan to give all poor Brazilians three square meals a day), Lula was forced, immediately on taking office last month, to delay (or possibly cancel) plans to renew the air force's ancient fleet of fighter jets and to mothball some big road-building projects.

Lula's predecessor, Mr Cardoso, found he had to keep inventing new taxes and to hack away at capital spending. But these measures seemed to make Brazil no less vulnerable to market panics; instead, they hobbled the economy's growth potential (for instance, in 2001 electricity had to be rationed). One reason was that Mr Cardoso had started owning up to the public sector's huge hidden liabilities, mostly resulting from previous governments' reckless policies. Just one such liability, resulting from a state bank's subsidy to home buyers, created in 1967, will cost 63 billion *reais*. In all, the “skeletons” (as they are known) cleared from the government's closets so far have added about 10% of GDP to the public debt. But there are still plenty more rattling around—worth, by some guesses, another 10% of GDP.



The way out for Lula is to push ahead with the fundamental reforms that Mr Cardoso left unfinished. Together these could allow him to target the government's resources more effectively and to raise the economy's underlying growth potential, as well as increasing tax revenues.

Off target

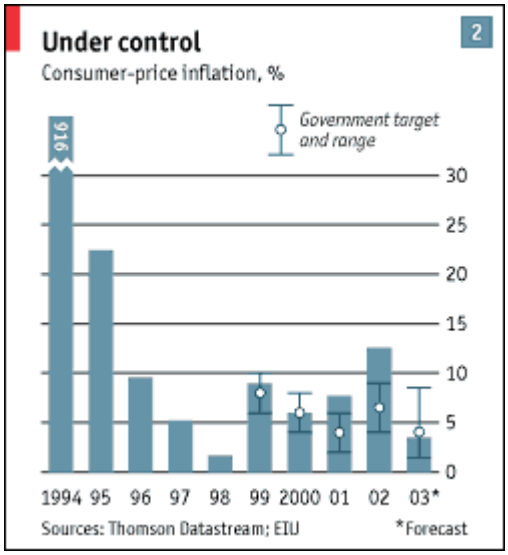
When the time comes, very soon, for Lula to take on vested interests (including those who elected him) to push through deep reforms, he should draw inspiration from a rough calculation by Marcelo Neri, an economist at the Getulio Vargas Foundation, a university. He says that about 50m Brazilians earn less than the 79 *reais* a month reckoned to be needed to eat properly. Bringing the income of each and every one of them up to this bare minimum would cost 20 billion *reais* a year. It sounds a lot, but it is only one-twelfth of Brazil's current social spending of 240 billion *reais*. The problem is not that the government itself is too poor to tackle poverty, but that so little social spending reaches those who most need it.

Mr Cardoso's government made a start on changing this (see article), but much more remains to be done. As Mr Palocci said in his inaugural speech as finance minister, “The state spends a lot, and badly.” During Mr Cardoso's term of office, real public spending, excluding debt service, increased by an impressive 6% a year (though Lula and his friends, then in opposition, constantly moaned about the Cardoso administration's “cuts”).

So where does all this money go? The biggest destination for social spending is pensions. For some groups, such as the millions of poor rural workers granted modest retirement benefits in the early 1990s, the pensions system is genuinely redistributive. But most pension spending is on people who are not poor and not necessarily old. This is especially true of the various pension schemes for public-sector workers at federal, state and municipal levels. These pay out 100% of final salary (whereas schemes in rich countries typically pay only 50-75%) and allow workers to retire unreasonably early, often in their 50s, sometimes to take another public-sector job that will entitle them to a second generous pension.

Mr Cardoso tried to change this repeatedly, but only partly succeeded. He did manage to introduce a new “taper” for the pension scheme for private-sector workers that reduced benefits for those retiring early; but when he attempted to cut retired public servants' benefits, the Supreme Court ruled the legislation to be unconstitutional. The drastic fall in the birth rate since the 1960s (when Brazilian women had an average of 6.3 children each, compared with 2.3 now), together with rapidly rising life expectancy, means that the contributions of today's workers will have to support ever-rising numbers of pensioners. The government says the combined deficit of all the pension schemes for private- and public-sector workers is now above 5% of GDP

and rising, though critics reckon that this exaggerates the problem: after all, the government, like other employers, should expect to make contributions to its workers' pension schemes.



Crunch time

Chile defused its pensions time-bomb by transferring workers into new, privately run pension funds, with the government borrowing money to endow these funds with assets. But Brazil is too heavily indebted already to be able to try this. And a gentle transition, in which new and less generous pension rules apply only to new recruits, will not be enough to stop the deficit growing. Existing entitlements will have to be cut, or pension contributions increased—or preferably both.

When in opposition, Lula and the PT opposed Mr Cardoso's attempts to sort out pensions. Now, in power, they have done an about-face and are promising to submit bold reforms to Congress by the middle of this year. Ricardo Berzoini, the new pensions minister, has talked of capping public servants' pensions—which can be more than ten times the current ceiling for private-sector pensioners of a mere 1,561 *reais*. So far, the signs are not promising: under pressure from military bosses, Lula has already agreed to exempt the armed forces from this reform. The largest trade-union confederation, outraged that those with the most egregiously generous pensions of all might escape cuts, is threatening a general strike if those privileges are preserved.

Reuters

Oh no, not more skeletons in the cupboard

The World Bank has put forward various other proposals to cut the pension deficit for Brazil's public service. These include raising the contributions being paid by current staff, and reviving Mr Cardoso's plan to cut existing pensions by the roundabout route of making retired staff continue to pay “contributions” (which would require a change in the constitution); raising the retirement age (not unreasonable, because Brazilians are living longer, healthier lives); indexing pensions to inflation rather than to the national minimum wage; and imposing a “taper” similar to that already in force for private-sector workers to discourage early retirement.

The deficit in the private-sector workers' retirement scheme is smaller but still needs to be reduced so that the government can redirect resources to Brazil's poorest. José Pastore, a labour-market economist, has put forward a novel solution: to cut workers' contributions instead of raising them, because current rates are so high that they cause widespread evasion. As things stand, employers and employees are each supposed to contribute 10% of salary to the scheme, and the self-employed are meant to pay 20%. Over the years, the burden of this and other payroll taxes has hugely boosted informal working, which now accounts for 54% of those in employment. In theory, no contributions, no pension; but once this generation of workers without entitlements gets old, the government will come under pressure to support them. Mr Pastore suggests offering workers a choice of contribution levels which will eventually provide pensions to match.

As well as fixing the federal finances, a rapid and effective pension reform could in the long term help to

solve the dire financial problems of many states and municipalities. Mr Cardoso's government refinanced their debts “one last time” and then passed a fiscal-responsibility law, which among other important measures banned future bail-outs. Some powerful governors and mayors are now pressing Lula to go back on this ban, but that could open the floodgates.

Making the money go further

Pensions are only one area where government spending is poorly targeted and Lula needs to make tough choices. Most places at the “free” (ie, taxpayer-financed) public universities go to youngsters whose parents have enough money to put them through private schools first, whereas students from poor homes, if they are lucky enough to complete their secondary education in the dismal state schools, have to pay to go to private universities. Well-paid graduates should be made to repay a share of their tuition costs, freeing up money to improve primary and expand secondary education for the poor.

Some of Brazil's myriad payroll and turnover taxes go into an alphabet soup of training and business-advice agencies known as the “S-system”. Trade unions and employers' associations also get their hands on all sorts of taxpayers' money, to spend on everything from apprenticeships to arts sponsorship. No doubt some of these “parastatals” (nominally independent but financed and regulated by the state) do some good, but few of them provide value for money. A UN official familiar with their workings graphically describes the better ones as “the occasional island of gold in a sea of shit”. Soon after the election, Lula's team announced plans to review much of this spending, as part of a proposed reform of trade unions.

The list of poorly directed spending goes on and on. Mr Giannetti, the economist, says municipal council chambers, with all the special allowances councillors award themselves and their armies of hangers-on, cost 3.6 billion *reais* a year. The councillors are supposed to scrutinise the work of the elected mayors who run the cities, but they do a lousy job. The same could be said of state assemblies. And the federal banks offer cut-price housing loans to millions of middle-class borrowers who could afford commercial loans, once again using resources that could be better spent on more needy citizens.

Last but not least, there is the considerable amount of public money stolen by corrupt politicians, officials and even judges. During the election campaign, Lula's advisers claimed that corruption was eating up 20-30% of public spending. That may have been an exaggeration, and many of the biggest scandals that emerged during Mr Cardoso's administration were old ones being uncovered at last. But tough action to stamp out corruption is one of Lula's most important challenges, not just because of the drain on the public purse but also because it undermines the rule of law and thus contributes to Brazil's appalling record of violent crime (of which more later). In local government, Lula's PT has a record of being less corrupt than most other parties, though it is not quite as saintly as it makes itself out to be.

A taxing problem

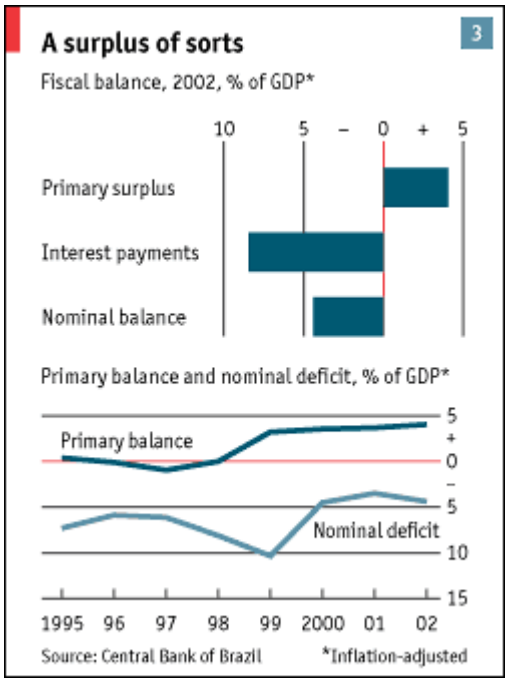
When Mr Cardoso came to office in 1995, he promised to fix Brazil's messy, growth-inhibiting tax system. Firms had to pay various turnover taxes in “cascade”, ie, they could not deduct the taxes they paid on their inputs from their output taxes, so as components passed down the production chain they attracted taxes on top of other taxes, making Brazilian products more expensive than imported equivalents or those assembled in Brazil from foreign parts. The heavy burden of payroll taxes, along with the restrictive labour laws, also discouraged firms from creating jobs.

Despite its early promises, Mr Cardoso's government was so fearful of losing revenue that it never pressed hard for tax reform. Indeed, to stave off financial collapse, it made the tax system even more burdensome by imposing new, supposedly temporary emergency taxes. Only in December did Congress, with a push from both the outgoing and incoming governments, at last approve the first stage of the reform, turning one of the less important cascade taxes into a value-added tax.

A thorough revision of the tax code is now needed to allow the economy to grow faster and create more jobs, while also increasing tax revenues and thus easing the government's financial problems. The current profusion of federal and local taxes could be replaced by a broad value-added sales tax, with the revenues shared among the different levels of government. The many income-tax allowances that the better-off enjoy could also be cut, reducing the scope for evasion, which is currently widespread.

The trouble with tax reforms is that they tend to create big winners and big losers. The winners keep quiet and the losers, whether industries faced with bigger tax bills or governors and mayors faced with big revenue losses, scream the house down. Any worthwhile reform will mean changing the constitution, which means winning a broad consensus in Congress. Lula's best hope is to propose a long transition period so that the losers have time to adjust, and tax rates can be changed to correct any decline in total revenues.

Another move that could ease the government's financial problems and boost economic growth is to grant independence to the Central Bank. Its new governor, Henrique Meirelles, formerly a boss at FleetBoston, an American bank, has raised this year's official inflation target by two percentage points to 8.5%, but has increased interest rates by half a point to show that he means to defend it. If he were given full autonomy to set monetary policy, the Central Bank would have greater credibility, and so might not have to keep interest rates at their current sky-high 25.5%. That would cut the financing costs of both the government and of business. Lula's economic team says pushing Central Bank independence through Congress is a top priority, though it faces opposition from the PT's left wing.



Vociferous vested interests stand in the way of all these reforms, which is why Mr Cardoso was unable to get them through, even with a congressional majority supposedly bigger than the three-fifths needed to change the constitution. Lula, with a minority government, has a mountain to climb, and quickly, while his post-election momentum lasts. If he succeeds, he may be able to banish the spectre of financial collapse, and Brazil may start growing at the 5% a year he dreams of, rather than the meagre average of 2.3% that it managed in the past eight years. Among other things, that would make it easier for him to tackle poverty.

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Three square meals a day

Feb 20th 2003
From The Economist print edition

Lula's "Zero Hunger" programme will not eliminate poverty on its own. But he won't be starting from scratch

"IF, BY the end of my term, all Brazilians are able to eat breakfast, lunch and dinner, I will have fulfilled my life's mission," said Lula in his inaugural speech as his country's president on January 1st. "While there remains one Brazilian brother or Brazilian sister going hungry, we have more than enough reason to be covered in shame." To end this national disgrace, the flagship of his administration's all-out attack on poverty would be *Fome Zero* (Zero Hunger), a scheme to ensure that even the poorest Brazilian will get three square meals a day.

The Vieiras: poor but not hungry

Having been born dirt-poor and known what it is like to go hungry, Lula is undoubtedly sincere in his pledge that he will do everything possible to put an end to the deep poverty that, by some measures, afflicts 50m of his compatriots. But criticism by many poverty experts—including some within his own party—has forced the president to reconsider his original version of *Fome Zero*. Inspired by America's Food Stamps programme, which President Roosevelt introduced in the Great Depression of the 1930s, this would have given poor people coupons to exchange for food in the shops. When critics said this would lead to widespread fraud and the development of a black market in coupons, as it did in America, Lula backtracked, but only partially. Recipients will now get cash, but they may have to prove they spent it on food – which, if enforced, will doubtless lead to a thriving industry in fake receipts.

So far, then, Lula's big idea is turning out not that different from the range of cash benefits for needy families introduced towards the end of Mr Cardoso's presidency. When he first took office, Mr Cardoso concentrated on cutting inflation (which in itself led to a big drop in poverty, because the poor had been least able to keep up with rising prices), cleaning up Brazil's financial system and privatising inefficient state firms. But in his last couple of years he oversaw the creation of a broad anti-poverty strategy which—for the first time in Brazil's history—aimed to allocate resources on the basis of need, as opposed to the vote-buying approach that had marked past social programmes.

Far from having to start from scratch, as he has claimed, Lula has thus inherited a well-established set of welfare policies aimed at improving the health and education of Brazil's poorest communities and putting cash directly into the pockets of poor families. His best bet is to continue, expand and improve his predecessor's welfare strategy, rather than try to invent something new. Mr Neri, the poverty expert at the Getulio Vargas Foundation, says that despite some criticisms, Mr Cardoso's welfare policies were "a veritable revolution," and that Lula "must not throw all this away".

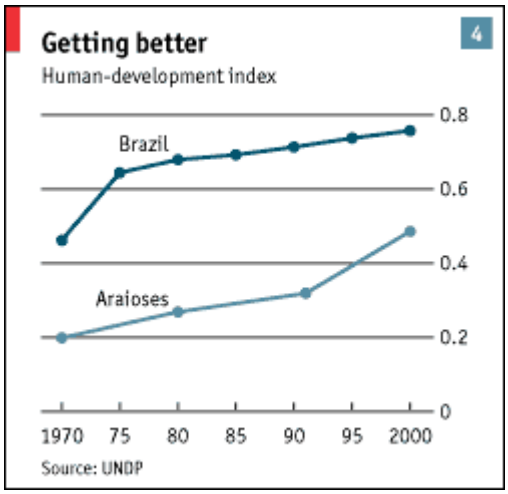
Life at the back of beyond

A visit to Araioses, a small, abjectly poor town of 35,000 people in the hot north-eastern state of Maranhão, shows that the anti-poverty strategy Lula has inherited is already beginning to bear fruit. In 2001 Mr Cardoso created the Alvorada project to reduce poverty in areas with a low Human-Development Index (HDI). This is a measure of deprivation devised by the UN Development Programme (UNDP) that takes into account education and life expectancy as well as income. By this measure, in 2000 Brazil as a whole had an HDI of 0.76 on a scale of 0 to 1 (see chart 4), compared with 0.94 for Norway, the world's most developed country. Araioses was Brazil's fifth-poorest municipality, with an HDI of only 0.49, slightly better than Bangladesh's. Its infant-mortality rate was nearly treble the Brazilian average, and

half the adult population could not read or write.

Araioses's elderly residents were already benefiting from the modest pensions given to retired farm workers in the early 1990s, but once the Alvorada project kicked in, all sorts of other federal programmes began to reach the town. About 3,000 families now get the *Bolsa-Escola*, a payment for sending their children to school regularly. Many also get help with buying food and gas for cooking. Local teachers' pay is bolstered by the education ministry's Fundef programme, which ensures minimum funding levels for schools in poor areas; and pupils get federally funded school meals. The health ministry sends teams of doctors and nurses to visit isolated communities in the countryside around the town, and pays for milk and dietary supplements for infants.

One of Lula's ideas—seeking private donations to supplement government spending on anti-poverty projects—has already been put into action in Araioses, where the Brazilian offshoots of two of America's industrial giants, GM and Praxair, are sponsoring government welfare schemes to overcome illiteracy and youth delinquency respectively. Edson Santos, the earnest young teacher who runs the literacy scheme, says it has now taught 2,000 locals to read and write. With the help of such programmes, "I see that we can escape from the situation we are in," he says, with a missionary gleam in his eyes.



Overall, locals feel that their problems are beginning to be tackled, and are not looking for big new initiatives. The mayor of Araioses, Pedro Silva Santos, urges Lula simply to "continue and perfect" his predecessor's welfare schemes. International bodies such as the UNDP and the World Bank are giving the new president similar advice, to the effect that he should continue to roll out schemes like the *Bolsa-Escola* and the Family Health Programme. There is scope for further rationalisation to bring together various welfare payments made by different ministries. Encouragingly, Lula seems to have taken this advice to heart. His ministers seem on course to continue and perfect many existing programmes, rather than invent new ones.

Could be worse

At the end of a sandy track leading out of town into the surrounding scrubland, in a house made of rough-hewn branches covered in clay, Lucia Vieira looks after her two children while her husband is out earning a mere 5 *reais* a day as a farm labourer. Surely they, in one of the lowliest homes in one of Brazil's poorest towns, must be among the starving that Lula hopes to feed? No, *graças a Deus*, says Mrs Vieira, they don't go hungry—especially now that they receive 15 *reais* a month from the Alvorada poverty-reduction project. It may be a modest sum, but it is enough to ensure that they even have meat on their plates sometimes.

Lula's special interest in hunger no doubt reflects his own childhood experience, but was also inspired by household-income surveys suggesting that up to 50m Brazilians—almost 30% of the population—do not earn enough to buy sufficient food. However, the link between income and consumption is surprisingly weak, says Ricardo Paes de Barros of IPEA, an official think-tank. The most reliable measure of malnourishment—reports from health workers, who weigh all the infants in their care each month—suggests that only 12m, or 7% of the population, are underfed.

The families of many underweight children are suffering more from a lack of health care and nutritional advice than from being too poor to be able to buy food, says Mr Paes de Barros. In rural areas like Araioses there are fruit trees, there are rivers to be fished, now there are free school meals and there is a sense of solidarity that encourages the sharing of food. Thus, leaving aside natural disasters, such as the periodic droughts that sweep Brazil's north-east, a huge programme of food aid might be missing the point. Better schooling, sanitation and medical attention may be of greater help to the poor. In the north-eastern town of Guaribas, chosen by Lula to pilot *Fome Zero*, locals say that no one is dying from hunger; what they really need is better sewers.

Asked what would be the most important thing that Brazil's new president could offer her family, Mrs Vieira clearly thinks it is a daft question. "*Emprego*", work, she says simply. Preferably something offering more than 5 *reais* a day. Opinion polls invariably show that Brazilians' main concern is a lack of

decently paid employment. Lula acknowledged in the election campaign that 10m new jobs were needed.

Dash for growth?

Meeting Brazilians' aspirations for more and better jobs will require a number of things to be done (see article), but the single most helpful change would be faster economic growth. Lula and his finance minister, Mr Palocci, say they are aiming for a growth rate above 5%. Many Brazilian politicians, and not just on the left, have long clamoured for a dash for growth, believing that this would provide the extra jobs to cure all social ills. There is nostalgia for the period from 1940 to 1980, when Brazil's economic growth rate was among the highest in the world. Real GDP increased by almost 11% in 1958 and by as much as 14% in 1973. Those were the days.

Well, only up to a point: in the so-called lost decades of the 1980s and 1990s, when economic growth was modest, indicators of social welfare such as infant-mortality rates improved by leaps and bounds, spurred by the restoration of democracy. A dash for growth would risk letting inflation get out of control, which would harm the poor more than the rich. Keeping a lid on inflation and reforming pensions and taxes to bring interest rates down from their current high levels is a more sustainable route to growth.

Lula may have put too much emphasis on hunger in its literal sense, rather than on the broader hunger for better living standards, but he is right to make the fight against poverty his top priority. For all its recent achievements, Brazil still has a lot of catching up to do. During the 1990s its infant-mortality rate fell from 48 to 30 per 1,000 births, but that is still a long way behind Chile's rate of ten. Vinod Thomas, the World Bank's director for Brazil, sums it up: “My impression is that Brazil in the 1990s did better than Mexico, India, and China in its social programmes,” though not as well as some East Asian countries. Even so, Brazil, overall, has “only risen from grade C to grade B.”

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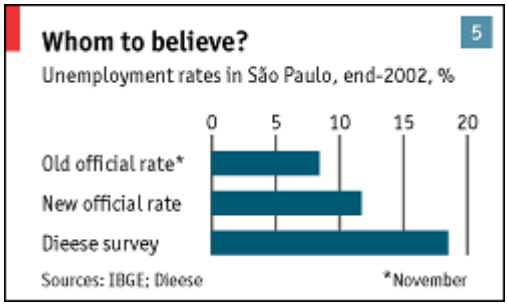
Jobs that grow on trees

Feb 20th 2003
From The Economist print edition

Brazil has huge potential for jobs growth, in everything from agriculture to electronics. But how to realise it?

FANCY a tangy, vitamin-packed glass of *acerola* juice? Or a bowl of delicious and ever-so-healthy *açaí* sorbet? *Camu-camu* jam on your morning toast? Brazil has all sorts of tropical fruits and other exotic produce to offer to novelty-loving, health-conscious consumers in rich countries, if only they knew about them and were able to buy them. Its abundant and fertile land also offers plenty of scope to expand production of better-known produce, from soyabeans to mangos. Although Brazil's giant, highly mechanised farms need few workers, there is significant potential to cut unemployment by expanding small-scale, labour-intensive agriculture, whether to supply local markets or for export. The country's stunning natural beauty—from rainforests to sun-baked beaches—offers opportunities to expand tourism, another big source of jobs. And given its huge home market, it should surely be producing more electronic goods locally. The challenge is turning all this potential into reality.

Brazil's official unemployment rate is not bad compared with those of its neighbours, or indeed of some rich countries, though during the Cardoso administration it crept up from about 5% to 7%. But this low figure was achieved partly by using a narrow definition of unemployment. When, at the end of 2002, Brazil's official statistics body adopted something closer to international standards, the rate shot up to 10.5%. But the new method still counts as employed even those who had only a few hours' ill-paid informal work in the past month. Dieese, a union-backed research body, reckons that unemployment in greater São Paulo, more broadly measured, is 18.5%, well above the region's official rate (see chart 5). That gap, together with the absence of a proper social-security net, explains why jobs always feature as Brazilians' top concern in opinion polls.



One of the PT's long-standing promises, which Lula reaffirmed during the election campaign, is of sweeping land reform to create rural employment. This would right the historical wrong, dating from colonial times, of a few giant landlords holding huge tracts of under-used land, denying millions of impoverished rural labourers the chance of working as productive small farmers. But Lula's election manifesto carefully avoided saying how many would benefit, and forgot to mention that Mr Cardoso had already settled over 600,000 families on the land, more than all his predecessors combined.

One of the country's most fertile regions, and the scene of many conflicts between landowners and the *sem-terra* (landless), is Pontal do Paranapanema, in the interior of São Paulo state. The region's weather—brilliant sunshine interspersed with occasional showers—and the abundant supply of water for irrigation make it ideal for growing all sorts of things. Coffee, once the main cash crop, has been hit by low world prices, but local growers are diversifying, especially into fruits. Oswaldo Dias, a local small grower, has been expanding his production of *acerola* berries to meet growing demand for their juice. He is also growing *urucum*, whose red-brown fruits are used as a natural food colouring. Whereas a soya plantation may employ only one person for each 200 hectares, says Mr Dias, *acerola* bushes require one or two people per hectare, and grapes, which many of his neighbours are now growing, need four per hectare.

Mr Dias is one of 1,300 small growers in Pontal who supply Fruteza, a local firm that has started exporting fruit pulp to bottlers in North America and Europe, where demand for tropical fruit drinks is rising. An extension to its factory to double its capacity is under construction, but Olivio Zanatta, Fruteza's boss, says he has been holding back until he has built up enough profits to pay for it all. At the exorbitant interest rates charged by the banks, he says, financing the project with a loan would be unthinkable. Like businessmen and farmers the length and breadth of Brazil, Mr Zanatta says the key to more job creation is to improve the supply of affordable credit.

Lula's election promise was to grant more cheap state loans to small firms and farms, but the government is itself up to its neck in debt, so he cannot afford to fulfil it. Only private banks can provide the credit needed, but why would they lend cheaply to small firms like Fruteza when they can lend to the public sector at rapacious rates? Only when the government stops crowding out private borrowing and achieves a big fall in interest rates will businesses of all sizes be able to afford to borrow to expand and create jobs.

The sweeping tax reform that Lula has also promised should help. The myriad payroll taxes and compulsory benefits that Brazilian employers must pay add up to 103% of salary, reckons Mr Pastore, the labour economist, compared with 9% in America. Besides discouraging firms from hiring, this also keeps pay down: as Fruteza's Mr Zanatta explains, if he has a budget of 1,000 *reais* a month for a given worker, once he has deducted all the payroll charges the worker ends up with less than 500 *reais* before income tax.

Land for the landless

The Pontal has seen many violent conflicts between various landless rural labourers' movements—especially the MST, the most militant—and landowners, who sometimes resort to hiring *pistoleiros* to shoot those squatting on their land. President Lula's promise of a sweeping land reform, besides helping towards his goal of Zero Hunger, is intended to cut unemployment and violence in the countryside. Estimates of *sem-terra* numbers vary widely, from 1.2m to 7.5m, partly because nobody knows how many recent migrants to the cities might come back to the country if land and jobs became available there.

Mr Cardoso's big land-reform programme helped to reduce the conflict somewhat, but can Lula end it? Bernardo Fernandes, a geographer at a local university who advises the MST, is optimistic. At the peak, he says, the previous government was settling 100,000 families a year; if Lula could raise that to 150,000, he would soon run out of new squatters. São Paulo's state government has proved that 200,000 hectares of landholdings in the Pontal area are public land that was stolen using faked titles. Mr Fernandes says that, to avoid long legal battles, the state has offered the holders of this land modest compensation to hand it over so that landless labourers can be settled on it. The same sort of thing could be done across Brazil.

AP

Lots of jobs on offer, but is the pay enough to live on?

At a local MST squat, where 800 people are camped out under plastic sheeting in the fields, Jacinto Bernadino, its organiser, says he has faith in Lula to find them a place of their own, and insists that his comrades could all be self-sufficient small farmers within three years. Agripino Lima, the mayor of the nearby town of Presidente Prudente and a big landowner, scoffs that the squatters are mostly townies, seeking a chunk of land to sell on, and those already settled in the Pontal area are not producing a single row of beans, just sponging benefits off the state. Mr Fernandes disagrees: not only are the former *sem-terra* growing enough produce to feed themselves, he insists, they are selling some of it cheaply in local markets, reducing hunger among the rural poor.

Both are right. Not far from the MST squat is an 850-hectare spread that in 1998 was expropriated and given to landless labourers. Some overgrown plots are clearly not being tended, but others have cattle and neat rows of crops. On one such plot, Adão Silveira and his brother are building a milk chiller alongside their cowshed that will enable them to sell to local dairies. They have been given state loans to

finance the chiller and the second-hand tractor they have bought a share in. Apart from their own hard work, all they need to keep expanding their little farm's output, says Mr Silveira, is more affordable credit.

The experience so far from Mr Cardoso's land reform suggests that Lula's government should increase the incentives for settlers to become self-sufficient, rather than just cranking up the numbers, which would probably increase the already high failure rate. Mr Cardoso tried to do this with a revamped version of his scheme, in which settlers would negotiate the land purchase themselves but also, eventually, have to repay its cost. The MST fiercely opposed this, but Lula should press on regardless.

Unstable oscillations

What about jobs in industry? In the election campaign, Lula and other candidates lamented Brazil's lack of an “industrial policy” and promised more of it—though no doubt they were aware of the five federal banks that hand out cheap money to business, of which the Brazilian Development Bank alone lent 38 billion *reais* last year. The PT's manifesto said that state largesse would have to be more selective, and recipients would have to demonstrate the economic benefits they were providing in return. One of the main targets of such aid would be electronics and machinery, in which Brazil has an $8 billion annual trade deficit. But the sector has already been the subject of copious amounts of “industrial policy”, with disastrous results. For years Brazilian electronics firms were protected by huge import tariffs, to “give them time to become competitive”. And, to “develop” Amazonia, they were given huge tax breaks to set up in Manaus, in the middle of the jungle, far from both domestic and foreign markets.

Rather than more industrial policy, what will encourage the electronics industry (and others) to expand in Brazil is the same old list of dull but necessary reforms to stabilise the economy and make the country a more welcoming place to do business. Mike McNamara, the boss of Flextronics, an American multinational which makes mobile phones, printers and other equipment near São Paulo, says that for his firm the most important factor in investment decisions is the stability of the local market. But Brazil has very abrupt economic cycles, sometimes shorter than two years, and its currency has recently suffered wild swings.

Other discouraging factors include high interest rates, the complex and burdensome tax system, and Brazilian bureaucracy. Setting up a company, for example, takes nearly three months. Constant changes in laws and regulations, and the slowness and unpredictability of the courts, also deter both home-grown and foreign businesses. “The judicial system is more challenging in Brazil than in most other countries,” says Mr McNamara.

The country's labour laws, with their emphasis on protecting employees, are also bad for jobs. They are the enemy of the workers, says Mr Giannetti, the economist, because they ensure that employers will avoid hiring freely. The labour tribunals receive 3m cases a year, many of them brought by former employees claiming not to have received all of their innumerable entitlements. Meanwhile, more firms are hiring informal workers to dodge the increasingly heavy payroll taxes.

Lula knows that the labour laws must be updated to create more jobs, and has promised to press his former union comrades to accept this. But he is also talking about cutting the working week with no loss of pay, which will create another disincentive for employers. The new Lula and his PT still seem to be in two minds about their move to the centre.

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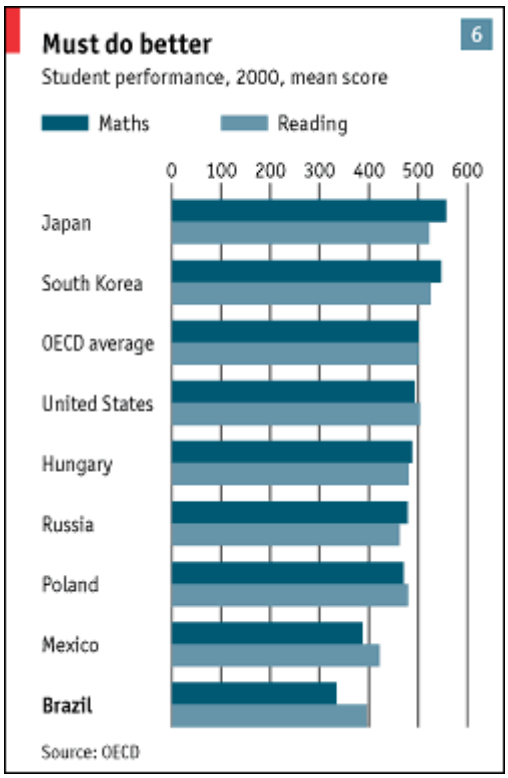
Start at the beginning

Feb 20th 2003
From The Economist print edition

The first step to ensuring Brazil's future prosperity is to improve its schools

HERE is a possible answer to why Brazil has not become rich like America. The World Bank calculates that two-thirds of the difference in income inequalities within the two countries—huge in Brazil, smaller in America—is due to differences in education. Two-thirds of Brazilian workers (including the president himself) never completed their basic education. Despite big advances in the 1990s, the 2000 census found that 13% of Brazilian adults are totally illiterate (compared with just 4% in Chile)—including 15 staff at the education ministry in Brasília, as Mr Buarque, the new minister, was aghast to discover.

School enrolments soared during the Cardoso administration—especially in primary education, which is now all but universal—but most young Brazilians still do not get a secondary education. According to the World Bank, only 33% of Brazilian teenagers attend secondary school, compared with 58% in Mexico and 98% in South Korea—which, remember, was poor only a generation ago. Unless the pace of improvement is stepped up, Brazil's deep inequality will remain, and competitiveness will deteriorate.

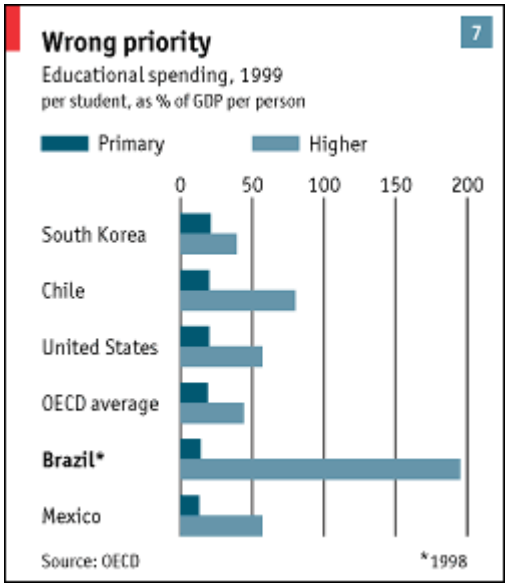


Moreover, it is not only the quantity of schooling that needs improving, but the quality too. Last year the Fernand Braudel Institute, a think-tank in São Paulo, asked Jane Wreford, an education inspector at Britain's Audit Commission, to visit some of the city's schools. She found overworked, ill-trained teachers who seemed to have no idea of what makes a successful lesson, classrooms devoid of books and other materials, and insecure school buildings plagued by vandals and drug dealers. Such conditions explain the dismal results that Brazilian teenagers achieved when, in 2000, they took part for the first time in the regular international tests staged by the OECD (see chart 6). By the time they are 14 and supposedly ready for secondary school, 74% of state-school pupils are at least a year behind, having had to repeat part of their primary schooling because they failed to keep up. Many such youngsters drop out and become delinquents.

Ahead of the election, Lula and the PT talked of making both secondary and nursery education universal within four years. Mr Buarque says he wants to double teachers' pay so as to attract back to the classroom all the qualified teachers who are “driving taxis and waiting at tables”. He aims to hire half a million extra teachers, repair 220,000 schools and build 30,000 new ones, and offer grants to all adult illiterates to encourage them to learn to read and write. This is an expensive wish list, so new revenues will have to be found or spending redirected.

Money, however, is not everything. Brazil's overall education spending, at 5.1% of GDP, is slightly above the rich-world average, but too much of it goes to the public universities (see chart 7), whose students are predominantly from richer families. Whatever their strike-prone staff may think, the universities are generously funded: they get 25% of all public spending on education for only 2% of the students, and funding per student is three-and-a-half times Brazil's GDP per head, which the World Bank says is the world's highest ratio by far. So although total education spending is close to world standards, school spending is some way behind.

One solution would be to require graduates to repay part of their tuition costs, as Australia and Britain are already doing. Paulo Souza, Mr Cardoso's education minister, was keen on the idea, but getting such changes through a Congress full of beneficiaries of this particular middle-class privilege was too daunting, and remains so. The best Mr Buarque might hope to achieve is to make universities more cost-effective by increasing student numbers without a corresponding rise in funding.



Financial carrots

Schools are run by the states and municipalities, which complicates things for the government. Nevertheless, a lot could be achieved by simply continuing and extending current policies. One of Mr Souza's useful innovations was Fundef, a federal subsidy to raise teachers' pay and other primary-school spending in areas where they were dismally low, principally in the poor north-east. The World Bank regards this scheme as a model for other developing countries. Brazil's new government sensibly plans to extend it to secondary schools.

Another of Mr Souza's policies, which his successor would do well to continue and expand, was to send cash straight to schools, to avoid it being eaten up by state and municipal bureaucracies. In Araioses, the poor town visited earlier in this survey, schools get 1,600 *reais* a month direct from the ministry, and their parent-teacher associations decide what to spend it on.

Within the school system there is plenty of scope for efficiency gains, which should make it possible to improve both the quality and the quantity of education at a fairly modest cost. Ms Wreford's study found high levels of absenteeism among teachers, partly because of weaknesses in disciplinary procedures and partly because teachers were exhausted from “moonlighting”, teaching evening classes in another school to make ends meet. Many of the pupils in these evening classes in turn were “repeaters” whose previous daytime lessons had been inadequate. A combination of better pay and tougher disciplinary measures should improve teaching and thus reduce repetition rates. Pupils would learn faster, and schools would have more places available to increase enrolment.

It is not just poor pay that discourages teachers and results in poor performance. Sergio Haddad of Educative Action, a charity, also points to the lack of a stable career path. Teachers in São Paulo state, for example, take part each year in a sort of lottery, in which they scramble to get into the best schools. This leads to constant staff changes and makes it harder to get good teachers to the ailing schools that need them most. Many states and municipalities already face crippling pension costs, so they hire teachers on temporary contracts to prevent them acquiring the generous pensions entitlements of permanent staff, increasing turnover still further. This is yet another reason why a reform of Brazil's pensions systems is so important.

Better training for teachers is also vital. The OECD's education experts think that part of the reason why East European countries' pupils do so well in international tests, despite fairly modest education spending, is that they have effective teacher-training programmes. In Brazil, according to Cláudio de Moura Castro, an education consultant, training courses often provide too much theory and not enough practical advice on how to deliver a lesson. Moreover, many teachers, especially in rural areas, enter the classroom with no training at all. Mr Buarque is planning to expand some successful distance-learning schemes for teachers that have been set up in various parts of Brazil.

Much of what the government can do would not cost much: for example, passing laws to promote stability in teachers' careers and improve training standards, and encouraging and disseminating good practice, whether in teaching methods or school management. Good practice is not impossible to find: besides deeply inadequate schools, Ms Wreford's study came across others, even in deprived areas, that seemed to be thriving against all odds. In Itapevi, on the edge of São Paulo, improvements to local schools appeared to have cut the local crime rate.

In others, though, murder, robbery and drug-dealing on the streets spill into the classrooms. Sometimes teachers are too afraid of their pupils and their families to discipline them, even for the most serious breaches. The case last September of a teacher from Rio's violent Duque de Caxias suburb who was stabbed after reprimanding pupils for drug-dealing was by no means exceptional. In the violent

peripheries of some cities, there is a danger of rising crime undoing the good that is being done by education.

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Getting away with murder

Feb 20th 2003
From The Economist print edition

Can Lula halt the rising tide of violent crime and put an end to corruption?

RESIDENTS of the Vila Cruzeiro *favela* studiously ignore the four heavily armed policemen making their way up the narrow, zig-zagging main street with weapons drawn, peering round each corner to check for snipers. Two excited young children run up, shouting: “Hello, police!”, but are quickly gathered up by their silent, nervous mother. This is community policing, Rio-style. Vila Cruzeiro is one of Rio de Janeiro's countless “urbanised” *favelas*. Over the years, muddy tracks have become asphalted streets and wooden shacks have been replaced by brick houses with sanitation. But even though the *favelas*' physical conditions have improved, the violent crime that some of their inhabitants inflict on the rest has worsened in recent years, making them, overall, more miserable places to live in than much poorer rural places where there is a sense of neighbourliness and crime is rare.

Vila Cruzeiro won national infamy last June when drug-dealers there disembowelled an investigative television reporter. The resulting media outcry prompted Rio's state government to include the *favela* in a community-policing project it had been half-heartedly pursuing. The idea is to install a regular police presence and win the co-operation and respect of the locals. This is in sharp contrast to Rio's traditional style of *favela* policing, which involves sporadically sending in squads of cops, armed to the teeth, to shoot up the place, then beat a retreat under gunfire from the gangs. Major Lucídio Vasconcelos, the officer in charge at Vila Cruzeiro, admits he is not expecting quick results. Locals fear that the project might not last, and if his community cops are withdrawn, gang leaders will take revenge on those who co-operated with the police.

The community-policing scheme was part of a wide-ranging programme to cut violence and reduce police corruption and inefficiency, introduced in 1999 by the then governor of Rio state, Anthony Garotinho. The brains behind the programme, Luiz Eduardo Soares, was sacked in 2000 after going to prosecutors over Mr Garotinho's head, accusing the “rotten band” in the police of corruption. Mr Garotinho let the reforms continue, though they lost momentum and the crooked cops were not cleaned out as thoroughly as Mr Soares had hoped. Now Lula has hired Mr Soares as national public-security secretary to tackle violent crime and rotten policing across the country.

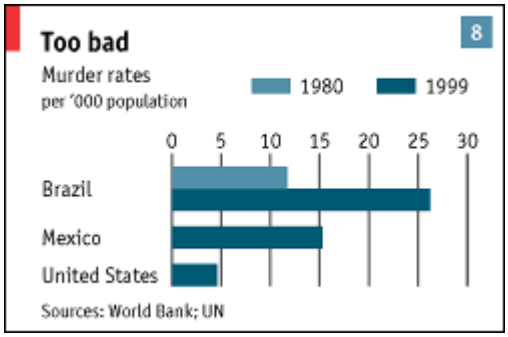
Though community policing does seem to have cut violence in the few places where it has been tried, critics say it has done so through an implicit pact with the drugs gangs: if they do business discreetly and there are no shootings in the area, they will not be bothered. Officers involved put it another way: the programme makes cutting violence a higher priority than preventing drug-dealing. But meanwhile the gang bosses get ever more cocky: in September they forced businesses and schools across Rio city to close in mourning for a felled comrade. And the murder rate has continued to rise both in Rio and in Brazil as a whole, making it one of the world's most violent countries (see chart 8, below). New prisons are being built everywhere, but the number of prisoners is rising faster than places to put them. Gang bosses control the jails and continue to run their criminal organisations from their cells.

Don't blame poverty

Until recently, Lula's PT liked to argue that violent crime was the result of poverty and inequality, and would lessen once social conditions improved. However, in recent years crime has risen as steadily as poverty as fallen. A more likely explanation is the impunity enjoyed by criminals, from gun-toting coke dealers to corrupt politicians. Only about one in ten murders is cleared up, and conviction rates for other crimes are paltry. When the big fish are caught, they often bribe their way to freedom or get their lawyers to string out the case for years.

Corruption is corrosive in several ways. Not only does it consume an unquantifiable but probably significant chunk of public money;

the constant stream of allegations against public figures—politicians, judges, policemen, prosecutors—also undermines the rule of law. And it is not just a matter of hands in the till: a congressional inquiry in 1999 found evidence that prominent local and national figures were involved in various interlocking crime gangs whose death squads rubbed out anyone who got in their way. After a few high-profile arrests, there has been little follow-up to the inquiry. Witnesses have met untimely deaths. In November, federal police supposedly investigating the local mafia in Espírito Santo state put a key witness, unprotected, in prison, where he was murdered within an hour.



Mr Cardoso sent various bills to Congress to reform the police and the judiciary, restrict the circulation of guns and so on, but got nowhere. It did not help that he had nine justice ministers in eight years. Without a strong and consistent push behind the reforms, vested interests were able to block them.

Various versions of a reform of the justice system made some progress through Congress, only to be killed off by whichever group of judges felt most threatened by them. Junior judges objected to a much-needed measure to unclog the courts by making them follow the rulings of more senior tribunals. There was widespread resistance to the proposed creation of a supervisory body for the judiciary, to include outside members. Oswaldo Silva, a federal prosecutor, notes that all of Brazil's organs of internal control, be it in the law, medicine, public administration or anywhere else, are reluctant to investigate members of their “club”. The judicial system, says Mr Silva, is “egotistical” in its refusal to make any concessions to speed or efficiency, allowing almost endless appeals. “If you could appeal to the pope, everyone would.”

Brazil's chronic legislative diarrhoea is another factor. Leafing through the official gazette, Mr Silva notes that under a counting system that started in 1946, federal law number 10,571 had just been been passed. On top of that, there are innumerable state and municipal laws, often poorly drafted, contradictory and counterproductive, and often designed solely to win publicity for the politician backing them. Bad or outdated laws are rarely changed. Under the penal-process code, dating from 1941, a video of someone committing mass murder is not admissible as evidence in court, only a paper print-out of freeze-frames.

AP

Rio's version of community policing

Mr Soares's reform plans in Rio included an operational merger of the state's two police forces, one a constabulary, the other a detective force. Like community policing, this has been implemented in some districts, but faces opposition from the old guard in the two forces, which in most states see each other as rivals, not colleagues. Rather than making them merge, Mr Soares now wants to cajole the two kinds of police to co-operate more closely with each other and with federal law-enforcement agencies. Federal grants will be offered to encourage police reorganisation and other crime-fighting schemes.

Vested interests

Why is it so hard to get something done? The crooked politicians, judges and cops are a minority, but their numbers are not negligible, and there is a strong tendency in these professions to close ranks against outside critics. Denise Frossard, a retired judge who put some of Rio's top gangsters in jail in the 1990s and has just been elected a federal deputy, reckons she is facing a “narco-bench” of perhaps 10%

of congressmen involved in organised crime, despite the expulsion of a few of the most notorious figures in recent years. At a time when there has been no leadership and no co-operation among the upholders of the law, the crime gangs have become increasingly professional and co-ordinated, “like a samba school, with everyone playing his part,” says José Vicente da Silva, a crime expert at the Fernand Braudel Institute.

Lula and his party, who in opposition used to rail against government corruption, now finds that the boot is on the other foot. Already his transport minister, Anderson Adauto, has come under pressure to resign because of allegations of corruption among some of his associates, just like some of his predecessors did in Mr Cardoso's day. Lula's chief of staff is dismissing these allegations as purely politically motivated, just as Mr Cardoso's used to do. Will things really turn out so different under the new government?

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What sort of president?

Feb 20th 2003
From The Economist print edition

Brazilian history offers Lula few positive role models. With luck, he might become one himself

LIKE many of his countrymen, Lula says the two past Brazilian presidents he most admires are Getúlio Vargas, whose dictatorships in the 1930s and 1940s saw the birth of many of the country's heavy industries; and Juscelino Kubitschek, who in 1960 built a new capital city in Brazil's interior to open up and develop its vast expanse of fertile land. Will future generations put President Lula alongside these two greats?

Mr de Carvalho, the historian, points out that although Vargas and Kubitschek are now fondly remembered, they were deeply unpopular at the end of their careers. Vargas, with the country in turmoil and the armed forces in revolt, put a bullet through his own head in 1954. Kubitschek's mandate ended in 1961, again amid bitter conflict with the armed forces, setting the scene for a coup three years later that led to 21 years of dictatorship. Mr Giannetti, the economist, notes that even when the economy was doing well, Brazil's social indicators did not improve in tandem with its rising industrial output.

As for Lula's big idea of negotiating a national consensus on sweeping reforms, Mr de Carvalho cannot spot any encouraging precedent in Brazilian history at all: as far as he can see, it was the country's dictators, not its democrats, who made things happen. Vargas, for instance, introduced big changes in his dictatorial early years, but later proved a failure as a democrat. Kubitschek was good at getting his measures through Congress, but he was proposing big spending projects, such as the construction of Brasília, rather than threatening vested interests, so he was pushing at an open door. The best example of a successful challenge to vested interests Mr de Carvalho can recall dates back to 1888, when Brazil's monarchy defied the plantation owners and decreed the abolition of slavery, only to find itself abolished the very next year.

The nearest thing to a Brazilian role model of a democratic president who pushed through tough reforms is none other than Lula's predecessor, Mr Cardoso. Although he failed to get his chosen successor elected, Mr Cardoso himself was quite popular when he left office. His defeat of inflation alone, never mind his education and welfare reforms, should guarantee him a place alongside Vargas and Kubitschek.

And foreign role models? Lula says his heroes include Felipe González, the former Spanish prime minister, and Nelson Mandela, South Africa's former president. Mr González and his Socialists offer an especially encouraging example. In 1977, as Spain returned to democracy after the Franco dictatorship, they joined the country's other main parties in signing the Moncloa Pacts, promising to share the political costs of vital economic reforms. Mr González continued the reforms after becoming prime minister in 1982 and Spain made a great leap forward.

Lula says the grand consensus he seeks is modelled on this Spanish precedent. But if he does not achieve it, and the lack of reforms triggers a fresh financial crisis, what then? Some fear he might try to ram through changes against the will of the traditional political elites, like Hugo Chávez in neighbouring Venezuela, with disastrous results. A greater danger, though, is that he turns out as weak and indecisive as Argentina's Fernando de la Rua, who quit as president in late 2001, leaving his country to implode economically and socially.

To avoid the fate of becoming a failed “President de la Lula”, he should bear in mind that, historically, Brazilian presidents have been strongest when they first arrive in office, says Mr Giannetti. A year or two into their mandates, Congress has discovered its power to say no, and presidents typically lose force.

In Lula's first few weeks of government, progress toward a Brazilian Moncloa has been mixed. Mr Cardoso's Social Democrats assert that the voters put them in opposition, so they must oppose the government, but they also also say they are ready to back Lula on key reforms such as those of taxes and pensions. Attempts continue to lure the other main party in the Cardoso coalition, the venal and

faction-ridden Brazilian Democratic Movement, into Lula's government. Meanwhile, the radicals within Lula's own PT are getting upset by his cosying up to conservative “oligarchs”, and some of those threatened by the proposed reforms—such as public servants—have started to fight back.

If Lula fails, Brazil, and its political left, will be knocked backwards, perhaps for decades. If he succeeds, his place in the history books will be assured.

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Feb 20th 2003
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Besides those quoted in this survey, the author would like to thank the staff of the World Bank, the UN Development Programme and the Fernand Braudel Institute for their advice and assistance.

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Feb 20th 2003
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Fear and management

When to terrorise the talent

Feb 20th 2003
From The Economist print edition

AP and Reuters

The spats over Derek Jeter and David Beckham raise questions about leadership

THE nation recoiled in shock. David Beckham (above right), Britain's most beautiful (and skilful) soccer player and the husband of Posh Spice, a pop diva, emerged from his house on Monday morning with a headband restraining his luscious locks to allow the world to photograph a wound above his left eye. Sir Alex Ferguson, manager of his team, Manchester United, had lost his temper after a big defeat and kicked a football boot, which collided with the Beckham eyebrow.

In sports, more than in most businesses, the management tactics are out in the open for all to see. Sir Alex uses the “hairdryer” treatment on his players: he stands so close when he bawls at them that his angry breath blows their hair. In the past week, America has harrumphed over a similar approach to player management. George Steinbrenner, main owner of the Yankees, had a dig at the partying habits of Derek Jeter (above left), his baseball team's star and as glamorous as (though less married than) Mr Beckham. Mr Steinbrenner prefers verbal volleys to flying boots: he once called Hideki Irabu, a pitcher, a “fat pussy toad”. Mr Jeter, like Mr Beckham, met his boss's jibes with restraint: “I'm in no way here to say anything bad about Mr Steinbrenner,” he told the press. “I know he's trying to motivate me to improve.”

Not many managers try to strangle their subordinates—as Bobby Knight, a former basketball coach at Indiana University, once did. But the ability to inspire fear has always been an essential tool of management. Alas, most books on leadership offer reams on trust and “emotional intelligence”, but barely a word on cracking the whip. Daniel Goleman in “Primal Leadership”, one of 2002's hit books, talks of “dissonant leaders”, ranging from “the abusive tyrant, who bawls out and humiliates people, to the manipulative sociopath.” Neither is offered as a desirable role-model.

Yet turn to, say, the autobiography of Sumner Redstone, the most driven of America's media magnates, and you find a man who undoubtedly combines negotiating brilliance with a great deal of, er, dissonance. “It may sound strange,” says Mr Redstone cheerily, “but...I invite confrontation. Confrontation leads to truth.”

Lots of other successful chief executives rule by terror. None, it must be conceded, reaches the standard set by John Patterson, who built NCR early in the 20th century. “When a man gets indispensable, let's fire him,” he would apparently say. One NCR executive discovered he had literally been fired when he found his desk and chair in flames on the company lawn. Modern laws on constructive dismissal and employee harassment have put an end to such fun. But Mr Redstone's fellow media magnate, Rupert

Murdoch, is notorious for his furious midnight telephone calls to unfortunate executives. Sandy Weill's reign at Citigroup has been marked by screaming sessions at those unlucky enough to cross him. After one prolonged rant, Mr Weill left the unfortunate executive with the words, “I guess now you know you're part of the team.”

Terror in the workplace is making a comeback these days. In an upswing, fear goes underground. Workers are scarce, and thus powerful; bosses must handle the talent with care. When times turn tough, as now, the balance of power swings. As Hank Paulson, chairman of Goldman Sachs, put it last month, in a speech that upset his staff, “in almost every one of our businesses, there are 15-20% of the people that really add 80% of the value.” In other words, 80–85% are largely redundant—and had better shape up fast.

When to put the boot in

Does fear really motivate? In sport, says Scott Snook, who teaches organisational behaviour at Harvard Business School, fear can become a barrier to taking risks, yet can “provide the essential emotional kick” needed to meet a challenge. Coaches need to strike the right balance (and the right player?) in order to develop talent.

Yet used in the boardroom, fear can be disastrous. Tony Couchman, a head-hunter at Egon Zehnder in London, recalls appraising the board of a large firm with a chief executive who so dominated his directors that they rarely questioned or challenged him. “Success in such a company depends on having a genius in charge and a steady market,” he argues.

So some kinds of fear may be unhelpful, particularly at times of change. Enron famously got its staff to rank each other and then fired the bottom 10% each year. With hindsight, that failed to encourage the questioning approach that might have prevented the firm's catastrophe.

Jim Collins, author of a book that explains why some firms succeed in making the leap “from good to great” and others fail, found that the approach to fear was a key distinction among firms that he surveyed. Although his work is often noted for championing quiet, thoughtful leaders over brash celebrity bosses, he found that the truly successful built firms in which people were “productively neurotic”. Although they did not personally apply Sir Alex's hairdryer approach to disciplining workers, they still fostered a strong self-imposed fear of failure. Microsoft employees quake all year at the prospect of their annual meetings with Bill Gates, where even being shouted at would not hurt as much as seeming to be an idiot.

Microsoft employees quake all year at the prospect of their annual meetings with Bill Gates

The driving fear of failure, points out Mr Collins, is not unique to corporate life. “I'm self-employed, and I live with constant fear,” he says. “But I'm self-afraid.” That kind of fear is common among creative artists—and also, adds Mr Couchman, in professional services, “where the person is the product and you have to manage lots of fragile little egos.”

Which is what soccer players are too. And for a good reason. Stefan Szymanski, an economist at Imperial College, London, finds a “staggeringly close” relationship between a football team's performance and its players' aggregate pay. That, he says, is not surprising: not only is the performance of Europe's footballers easily visible, week by week, but—unlike American baseball players—they are also unusually free to move teams. As the burgeoning management literature on human capital points out, when talent can walk, that freedom gives it huge market power.

If the bruised Mr Beckham is ready to put up with Sir Alex, the reason may be that Manchester United usually plays in Europe's Champions' League, and he needs the exposure to win the promotional work that generates much of his income. As for Manchester United, with a market value of £300m ($500m), it can ill afford to lose its stars and may want to reconsider extending Sir Alex's tenure—for all his success.

Sir Alex is a throwback, says Mr Szymanski, to the days when clubs controlled their players' destinies—as they still do, to some extent, in American baseball. “Monopoly creates terror and bullying,” he argues. “Competitive markets create reasonable behaviour.” For other firms, the same holds true. As more and more workers acquire human capital that reduces their dependence on a particular employer, the bullying boss will become rarer. In a downturn, though, even top talent should beware of flying boots. Duck!

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Deals

Virtual bids

Feb 20th 2003
From The Economist print edition

Business is being a tease

SO MANY promises; so little action. These days businessmen are more likely to hit newspaper headlines for thinking of doing a deal than for actually doing one. Hugh Osmond, who almost-but-not-quite took over PizzaExpress, a British restaurant chain, last year, is the latest contributor to an outbreak of virtual dealmaking that is sweeping the corporate world. On Febuary 19th, Mr Osmond confirmed that he was considering making an offer, which could be worth £8 billion ($13 billion), for Six Continents, a troubled hotel and pub giant.

“He's trying it on,” laughs Mark Reed, a leisure analyst at Teather & Greenwood. “He's got a tiny shell company valued at £40m. Something this size is more about ego.” Whether or not Mr Osmond does strike, he is not the only businessman using the potential of a deal to grab attention. Last week Richard Li, a Hong Kong tycoon, withdrew a mooted offer for Cable & Wireless, but not before newspaper headlines worldwide had brightened his fading image. Britain has a particularly strong crop of serial posturers, including Philip Green, who once failed to buy Marks & Spencer (he is now chasing Safeway), and Tom Hunter, who has just noisily failed to buy Allders, a department-store chain, and has also ended his “interest” in its rival, House of Fraser.

The targets are partly to blame for the virtual-bid trend. Firms with lots of property, such as shops, hotels and health clubs, are working hard to fuel rumours that buyers are about to pounce and unlock the value of their assets, so as to prop up sagging share prices—even though few hard deals materialise. This month PizzaExpress leavened an 18% drop in first-half profits with a continuing assurance that private bidders really are circling. Honest.

The depressed state of the mergers and acquisitions business means that investment bankers are also keen to stir the pot. And the media, too, tries to turn virtual-bid stories into real ones. The financial press has devoted countless pages to the six European and American groups stalking Safeway, despite the fact that only one has actually made a firm offer. (Even *The Economist* pleads guilty.)

Virtual-bid stories can certainly be colourful: consider the recent headline in Britain's *Sunday Times*, which boasted “Why I was glad I set fire to a Hong Kong billionaire.” According to the paper's new business editor, it was pouring his flaming sambuca cocktail on to Richard Li at a party in Davos which prompted the Asian tycoon to tell him about his acquisition plans. Ah, well. So what if the deal never happened? “Waiter. Gissanother shambuca!”

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Reuters

Screen test

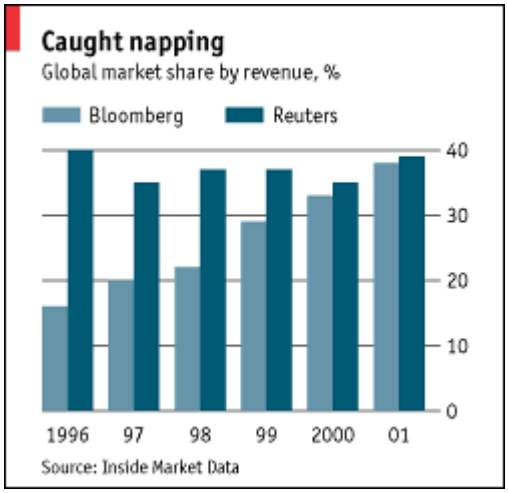
Feb 20th 2003
From The Economist print edition

Is Reuters terminally ill?

SHORTLY before becoming head of Reuters, in mid-2001, Tom Glocer toasted 150 years of the financial-information firm's history and the opening of its new building on New York's Times Square at a party well supplied with champagne and luminaries. Weeks later, Mr Glocer chopped 1,100 jobs and proposed a restructuring plan. This week, as he unveiled a pre-tax loss for 2002 of £493m ($740m), Mr Glocer announced yet another 3,000 job cuts and an accelerated restructuring plan. But is time running out for him to rescue Reuters from decline?

In 1996, Reuters still dominated the financial-data industry, which generates 90% of its revenues. With 40% of the world market, it dwarfed Bloomberg, its upstart American rival, founded in 1981. But since then, Bloomberg has made all the running, more than doubling its market share.

Reuters' latest loss was mostly due to write-downs and losses at Instinet, its electronic share-trading operation, which is reeling from the collapse in trading on Nasdaq. Otherwise, Reuters made an operating profit. But ominously, the core of its business, the terminals it serves, fell by a hefty 18%, to 493,000, while Bloomberg's terminal count probably edged higher. Reuters still supplies three times more terminals, but its average revenues from each are barely a quarter of Bloomberg's—£2,788 a year to £10,000—says Andrew Gordon-Brown at J.P. Morgan.



Even before the post-bubble downturn hit financial firms, bank mergers had led to a consolidation of trading rooms and so to cancelled Reuters contracts. Since then, lay-offs have hastened the trend. Reuters' news service, which earns 10% of revenues, has been hurt by the media slump.

These cyclical troubles mask structural weakness. Reuters has been thumped from two sides. At the lucrative top end of the market, thanks in part to savvy marketing and its popular instant messaging, Bloomberg has swept up business from under Reuters' nose. Bloomberg has one product, sold at one price, next to Reuters' many offerings. But Bloomberg's training staff are more dynamic. Traders think its colourful terminals are cooler. In the boom, banks let traders clutter their desks with both systems—hence Reuters' fairly static market share. Now, they are having to choose; most keep the Bloomberg.

The bottom end of the market, meanwhile, has been commoditised by a combination of the internet and newer operators, such as Moneyline Telerate, Thomson Financial and Proquote. Such companies sell cheaper, more basic packages to clients who do not need a luxury package. Proquote, for instance, charges about £175 a month for its most basic service; the upmarket Bloomberg is £900.

Even Reuters' news service is no longer indispensable. A trader can top up a cheap market-data service with news from, say, Dow Jones newswires. Reuters still sells its wire service to newspapers and media firms. But, for the financial industry, the newswires serve more as a branding device, reinforcing its image as a trusted and accurate source. With 2,500 journalists, in 198 bureaus, it is a costly business, though.

The first American and first non-journalist to head Reuters, Mr Glocer inherited from his predecessor, Sir Peter Job, a bloated, self-satisfied, rather patrician organisation that operated more like a branch of the civil service than a leader of the information age. Decision-making was agonisingly slow. Reuters

launched its own instant-messaging system only last October, although the idea had been discussed for years. It was, in Mr Glocer's words, “the culture of the Oxford debating society”.

Reuters had also strayed into unrelated businesses, such as IT consulting and enterprise software, where it had no competitive advantage. For all this, Sir Peter and Sir Christopher Hogg, Reuters' chairman for the past 18 years, are mostly to blame.

So far, Mr Glocer has concentrated on squeezing costs. Overall, he has sliced one-third from the 2001 payroll—though Reuters will still employ 13,000 people in 2005, compared with 8,000 at Bloomberg today. He is pulling out of peripheral consulting businesses. He has shed 56 non-core investments. He is working on cost savings by unifying the different computer systems Reuters operates on. After restructuring charges of £340m in 2003-05, Mr Glocer plans to save £440m a year.

Mr Glocer insists that “cost reduction isn't only a knee-jerk reaction, it's a strategic tool.” By itself, however, it does little more than manage decline. Where will growth come from? Mr Glocer's answer is partly to simplify the product line—“our business is too damn complicated”—and partly to launch new, cheaper services.

His other, more intriguing idea, is to build on Reuters' reputation for independence by entering the equity-research market. Mr Glocer has no immediate plan to hire research analysts, but he intends to position Reuters as a wholesaler of independent research. To this end, he has acquired Multex, a company-research group. The plan could develop, however. Eliot Spitzer, New York state's attorney-general, who has won some $450m for independent research in his Wall Street global settlement, is an old Yale friend of Mr Glocer: “Eliot and I go back a long way.”

It is one thing to have a good idea, quite another to get it done. Mr Glocer knows the business—he is a lawyer by training, a geek at heart—and has drive. But he has struggled to transform the Reuters culture from stifling bureaucracy into something dynamic, commercial and, yes, Bloomberg-like. One problem is that he lacks a London power base. Insiders suggest that he may feel isolated, and would have shaken things up faster were it not for resistance from old-timers. Against such cultural inertia, the best he may be able to do is to stave off decline—but Reuters will be a shadow of its former self.

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Fallout from Mannesmann

Breach of trust?

Feb 20th 2003
From The Economist print edition

German corporate governance is literally on trial

THE takeover of Mannesmann, a German conglomerate, by Vodafone, a British telecoms firm, in 2000 was both the priciest acquisition ever and the first hostile takeover of a German by a foreign firm. Now it may make legal history as well. On February 17th, after a two-year investigation, state prosecutors in Düsseldorf charged six senior executives associated with Mannesmann over the approval of payments to top managers when Mannesmann was acquired. Those in the dock include Klaus Esser, then chief executive of Mannesmann, and perhaps the two most powerful men in corporate Germany: Josef Ackermann, boss of Deutsche Bank, and Klaus Zwickel, head of IG Metall, a mighty German trade union.

If it goes ahead, the trial could lead to the resignation of Mr Ackermann, who took over at Deutsche Bank last year. It may also prompt a tightening of the country's new code of corporate governance.

The accused were all members of Mannesmann's supervisory board, which under Germany's two-tier board structure appoints the executive management board and exercises strategic oversight. The board members are charged with *Untreue*—meaning breach of trust, or being an accessory to a breach of trust—when, before the takeover, they approved payments totalling DM250m ($125m) to Mr Esser and other managers of Mannesmann. Mr Esser received DM61m, half of it contractual severance pay. The rest was a discretionary “appreciation award” for his 11 months running Mannesmann.

At the time, this struck many Germans as far too redolent of American corporate values—a feeling that has deepened since. Whether it was illegal is harder to say. Theodor Baums, at the University of Frankfurt, was asked for his thoughts on the award before it was made and found it acceptable. He cites work by Arthur Andersen, a now defunct auditor, which calculated what the award could have been in share options given when Mr Esser was appointed, and came up with 77,000 options. This, it said, was hardly exceptional for a boss—which, though true, does not deal with the objection that Mr Esser was not actually awarded any share options.

Martin Peltzer, a lawyer in Frankfurt, thinks that Mr Esser's award was dodgy. Mr Esser had fought hard against the Vodafone bid. But he “gave up resistance against Vodafone the day he knew about his compensation package,” says Mr Peltzer.

Will any of the executives be convicted of a crime with a maximum penalty of five years in jail? Messrs Ackermann and Zwickel did not gain personally from the awards. Most commentators think it will be hard to prove any wrongdoing, as the law is so vaguely worded. Article 87 of Germany's company law says that a supervisory board can decide on pay, bonus, allowances, insurance, provisions and perks as well as pensions and payments to family members after a death, for any member of its management board. The only limit on their remuneration is that it must be “commensurate” with the bosses' jobs, as well as with the condition of the company.

But only the defendants have so far seen the state prosecutors' charges, in a document of almost 600 pages. And Martin Sorg at Binz & Partner, a law firm in Stuttgart that triggered the case by filing charges in Düsseldorf in February 2000, expects convictions. If Mr Ackermann were convicted he could not remain boss of Deutsche Bank. He may yet temporarily step down during the trial, though at present he is denying any such plan.

The trial will certainly trigger fresh debate over executive pay, relations between the management and supervisory boards, and the role and competence of each board. As with much else in Germany today, the result is unlikely to be a wholehearted embrace of American practice.

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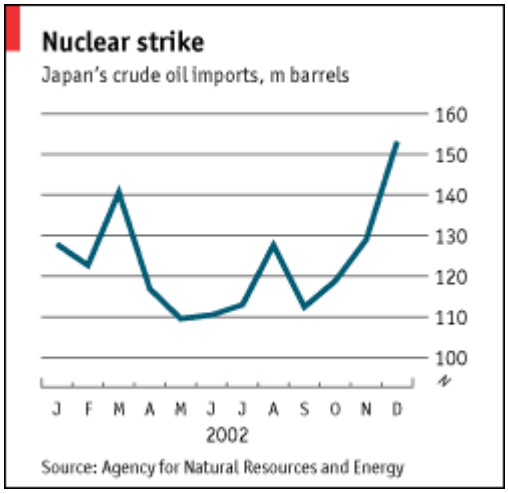
Energy markets

Nuked

Feb 20th 2003 | TOKYO
From The Economist print edition

Add Japan's faltering nuclear programme to the energy maelstrom



POLITICAL turmoil in Venezuela, a strike in Nigeria and a likely war in the Gulf have already had a dramatic impact on oil prices, by raising fears of shrinking supply. Into this maelstrom has come a fresh source of demand. Tokyo Electric Power (Tepco), the world's largest private electric-power firm, has had to close down 13 of its 17 nuclear reactors—which usually supply 44% of Tokyo's electricity—after it was caught falsifying safety records involving cracks at some nuclear-power plants last September. It may have to close the rest for safety checks in April.

As part of its efforts to cover the shortfall, Tepco has increased production at its oil-burning thermal power plants. By last October, crude oil imports shipped to electricity firms were more than three times the levels of a year earlier. By December, they were five times higher. Over the first ten months of 2002 Japanese oil imports fell, possibly due to Japan's economic woes; in November they were up by 11% from a year earlier, and in December by 20%, according to the Ministry of Economy, Trade and Industry. The rise is also the result of unusually cold weather in Japan of late—and perhaps other mystery factors that analysts are struggling to identify.

The result is that Japan will consume an extra 600,000 barrels a day until April, estimates J.P. Morgan. Although that is less than 1% of global consumption, in oil markets an awkwardly timed glitch can have a huge impact. Japan's problems could hardly be worse timed. Since last summer, primarily because of Venezuela, stocks have been declining at an unusually fast rate. This has accelerated; they are now shrinking by 1.2m barrels a day more than past seasonal trends would suggest, to less than one-third of their five-year average, according to J.P. Morgan.

In the months ahead, Japan is unlikely to put further pressure on the market—but only because its oil-fired plants are working at full capacity. Indeed Tepco has begun a campaign to ask consumers to conserve energy, saying that a cold snap in March could otherwise wipe out its safety-net of supplies. The outlook for Tokyo's hot and humid summer, when demand for electricity is at its peak, is grim. Tepco reckons that it may fall short of expected demand by as much as 20% if its nuclear-power plants remain closed. Tepco will probably push to restart its reactors, claiming they are safe. Many residents will no doubt respond that they would be happier increasing their exposure to the risks of the oil markets instead, even if consumers elsewhere might wish otherwise.

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Mobile phones

The origins of Vertu

Feb 20th 2003
From The Economist print edition

Is there really a market for a $20,000 mobile phone?

Vertu does not come cheap

IF YOU can spend $20,000 on a watch, why not on a mobile phone? That is the idea behind Vertu, which describes itself as “the first luxury communication company”. Its stylish handset—the company prefers to call it an “instrument”—features a sapphire-crystal screen and ruby bearings, and is available in stainless steel, gold and platinum finishes, with prices ranging from $4,900 to $19,450. Since its launch, the phone—sorry, instrument—has become a celebrity favourite. Gwyneth Paltrow, an American actress, was the first customer. Madonna and Mariah Carey are said to be Vertu fans; another singer, Jennifer Lopez, is reported to own three. Vertu is the brainchild of Frank Nuovo, a design guru at Nokia, the world's largest handset-maker, of which Vertu is a subsidiary. But is there really a big enough market for luxury phones?

The company insists there is. After all, as with luxury watches, ink-pens and cars, your choice of mobile phone is increasingly a form of self-expression. And although celebrity customers get all the attention, says Danielle Keighery of Vertu, obscure rich people are buying the phones too. She refuses to be drawn on sales figures, other than to say that the firm is “very pleased” with the response since the handsets went on sale last August.

A big selling-point is a special button that connects the user to Vertu's dedicated concierge service, which can organise travel, restaurant and hotel bookings, or find a good doctor or florist in a foreign city. When Ms Paltrow mislaid her phone's charger she called the concierge and a new one arrived within minutes. The concierge service is available worldwide in five languages. Detailed records are kept of each customer's preferences.

By selling handsets on the basis of craftsmanship, style and service, rather than whizzy features, Vertu is taking a different approach to that of the technology-obsessed mobile-telephone industry, which is meeting this week at the 3GSM conference in Cannes. Vertu has stayed away. It prefers to launch its products at fashion shows—it unveiled its newest model last month at Paris Couture Week. The Vertu handset's monochrome screen, above-average weight, and lack of support for such technologies as Bluetooth and GPRS leaves geeks unimpressed. But they are not the target market. Besides, new features can be added by switching the handset's removable innards: a free colour-screen upgrade is planned later this year.

Not everybody is convinced. Sagra Maceira de Rosen, a luxury-goods analyst at J.P. Morgan, thinks that Vertu is aiming too high. The idle rich who are expected to buy the phones are unlikely to need the concierge service because they have armies of assistants already, she suggests. The firm should perhaps be aiming at busy investment bankers instead (if it can find any). Nor is Vertu a logical brand-building exercise for Nokia, observes Ben Wood, an analyst at Gartner. Vertu's parentage is kept quiet, so Nokia's mass-market handsets are unlikely to benefit by association. Nokia already has by far the strongest brand in the industry.

But many luxury brands, observes Ms Keighery, subsequently launch more affordable versions of their products. So the gap between Vertu's cheapest phone and Nokia's most expensive may yet be closed. In the longer term, Vertu plans to exploit the emergence of “wearable” technology, as phones morph into jewellery.

Here, Vertu may be on to something, says Sofia Ghachem, an analyst at UBS Warburg. Siemens, another handset maker, has just launched a new range of wearable “fashion accessory phones” under the name Xelibri. It will produce two “collections” of Xelibri phones a year, in the hope that marketing phones as fashion items will encourage people to buy new handsets more often. With market penetration at around 80% in western Europe, growth in handset sales has stalled and Siemens believes its new approach could give the industry a much-needed boost.

At the moment, the industry's official line is that future growth will come from the adoption of whizzy new data services delivered over third-generation networks. But despite the torrent of technological announcements from Cannes this week, demand for such services is uncertain and the mood is gloomy. Pushing phones explicitly as fashion accessories, as Vertu and Siemens are now doing, might be a good fall-back plan. If data services turn out to be a niche market, says Ms Ghachem, “fashion is another way to go.”

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Yacht racing

Another tack

Feb 20th 2003 | HAURAKI GULF, NEW ZEALAND
From The Economist print edition

Plans are afoot to make the America's Cup more commercial

AP

Spot the billionaire

"AMERICA'S Cup racing is so cheap," jokes Larry Ellison, the billionaire boss of Oracle Corporation, "I can't think why more people don't do it." Pursuing yachting's most prestigious prize has always been expensive. But the cost of competing now compares with that of running a Formula One motor-racing team.

Unlike the travelling car-racing circus, the sailing event earns teams hardly any revenues. Before losing in the finals of the Louis Vuitton Cup last month (which decides who will challenge for the "auld mug"), Mr Ellison's 140-strong Oracle BMW Racing team had worked its way through nearly $100m, mostly from Mr Ellison's own capacious wallet.

Alinghi, the Swiss team that beat Oracle BMW and is now poised to defeat the holders, Team New Zealand, has a budget of $65m, mostly from the boat's navigator, Ernesto Bertarelli—who, if not quite as rich as Mr Ellison, is still worth several billion dollars, thanks to his family's stake in Serono, Europe's biggest biotech company.

America's Cup racing has always been the preserve of very rich men, from the tea magnate and perennial challenger of the inter-war years, Thomas Lipton, to such 1980s media tycoons as Ted Turner (of CNN fame) and Alan Bond, an Australian who triumphed 20 years ago and was later jailed after the collapse of his business empire. But since then costs have rocketed.

America's Cup yachts increasingly resemble sea-borne advertising hoardings: Alinghi has the logo of Switzerland's biggest bank, UBS, and that of Infonet, a communications firm, on its mainsail and hull. But the financial contribution of even big-name sponsors covers only a small part of the cost of keeping together a team of more than 100 well-paid people from the end of one challenge to the next. Some sailors, such as Alinghi's Russell Coutts and Brad Butterworth, are on retainers of nearly $1m a year.

Tapping TV revenues might help. America's Cup racing offers beautiful boats and settings; close, intense races; extremely high technology combined with extraordinary sailing skill; and plenty of larger-than-life characters both on the water and off it.

But the key is a better product for sponsors who want year-round exposure. The present approach of cramming all the races into a five-month period once every three years and holding the regatta in one of the remotest corners of the world is disastrous. Which is why Messrs Bertarelli and Ellison have devised a new idea: to make the America's Cup more like Formula One—televisually the world's biggest and richest sport.

They envisage a series of qualifying regattas, leading up to the finals, either annually or every two years. Teams would race in different places, from San Francisco to Hong Kong via Cowes, for the privilege of meeting the defender in his home waters (possibly Las Palmas, in the case of the landlocked Swiss). More money would attract more teams—not always reliant on funding by billionaires.

Only the defender and the "challenger of record" (Mr Ellison, if Alinghi wins) can initiate big rule changes. If the Kiwis were to win—as *The Economist* went to press they trailed Mr Bertarelli's outfit 3-0—the contest would stay in Auckland, where it adds an estimated 1% to New Zealand's GDP. But if Mr Bertarelli takes the cup to Europe, expect big changes.

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Face value

Charles Grassley, class warrior

Feb 20th 2003
From The Economist print edition

A top Republican senator mistakenly declares war on corporate-tax dodging in America

AP

AS EVIDENCE of the shifting politics of taxation in America, consider the acrobatics of Senator Charles Grassley. Five years ago, Mr Grassley led his colleagues on the Senate Finance Committee in a spirited attack on America's Internal Revenue Service (IRS). This agency's overzealous tax collectors, said Mr Grassley, used "secrecy and intimidation" as it crushed honest families and hard-working businessmen. Indignant at this abuse of power, Mr Grassley helped to cut the IRS budget.

Now, the indignant senator is back—only this time, he spits bile at America's businessmen, who appear to have morphed in the intervening years into greedy monsters, using clever tax shelters to shield their profits from the IRS. Mr Grassley now promises more help for the IRS and a war against tax-shelter promoters and business fat cats. "We have to hunt them down", he thundered last week at a room of terrified accountants.

Mr Grassley, who is now the Finance Committee's chairman, has just published an exhaustive report on the tax affairs of Enron, which involved spending millions of dollars on accountants and bankers to produce a federal tax bill totalling only $63m between 1996 and 2001, despite huge reported (but perhaps fictitious) profits. The advisers did this by selling Enron complicated tax structures (with butch names like "Project Valhalla" and "Project Renegade"). What is more—and this is the really inventive bit—Enron booked its tax savings as profits, and turned its tax department into a profit-centre with annual revenue targets.

The latest Enron revelations coincide with odd goings-on at Sprint, a telecoms firm from which two top executives (including the boss, William Esrey) have been ejected after the IRS disqualified a tax shelter they used to shield themselves from tax liabilities incurred through the exercise of stock options. Presumably, one thought behind the tax shelter was to encourage the two to hold on to the Sprint shares they acquired by exercising their options, rather than sell them to cover their tax bill.

But although Mr Esrey now faces a tax bill that could bankrupt him, Americans—in their present mood, at least—seem to see his behaviour as part of a general weakening of the fairness of the tax system. Thanks to the wicked ingenuity of their advisers, companies, executives and the rich are not, it is widely felt, stumping up their fair share. This conspiracy of the rich is also said to lie behind President Bush's recent proposal to end the double taxation of dividends, which go mostly to the well-off. Tom Daschle, the Senate's Democratic leader, calls Mr Bush's plan "obscene".

Mr Grassley proposes two reforms. One is a bill that would aid the IRS's recently launched attack on tax shelters. This attack relies on a system of voluntary disclosure: tax filers report the structures they are using, and the IRS vets them for legitimacy. So far, the IRS has been disappointed by the small number of filers who have turned themselves in. By increasing the penalties for failing to disclose suspect transactions and stripping tax filers of certain legal defences (such as having obtained professional advice), Mr Grassley's bill seeks to encourage greater honesty.

The second reform would make it harder for American companies to avoid taxes by incorporating themselves offshore in such lightly taxed places as Bermuda. This is a trend that gained notoriety last year when Stanley Works, a manufacturer from Connecticut, sought a mid-Atlantic domicile for its tool-

making business. Under IRS rules, American companies must pay taxes on their worldwide profits. By incorporating abroad, firms can exclude foreign-earned profits from their American tax returns. The legislation that Mr Grassley champions would let the IRS ignore offshore incorporation when levying taxes if, in other respects, the firm remains American.

Perhaps Mr Grassley, by showing more sensitivity to the changing public mood than his president, is doing his party a favour. After all, the best Republican defence against the accusation that America's party of business is one of the problems that plague American capitalism may be to ape the company-bashing rhetoric of its Democrat opponents. Perhaps.

The unavoidable truth

Yet the big risk is that Mr Grassley's rhetoric leads to bad policy. One problem is practical: new rules will spawn new strategies for avoiding them. The successors of Enron will always find it easier to recruit talent than the IRS. Far better to lower the demand for tax dodging than to squeeze the supply, as Mr Grassley hopes to do by shaking down those wicked bankers and accountants. Why not bring America's corporate-tax rate into line? From 1996 to 2002, the average corporate-tax rate among the 30 rich countries of the OECD fell from 37.6% to 31.4%. America's remained at 40%, below only Belgium, Italy and Japan among high-taxing OECD peers. Socialist Sweden has a corporate-tax rate of 28%. Ireland's is 16%. American firms must compete for capital in a liquid global market. No wonder they waste so much talent finding ways to lower their tax bills.

Some policy wonks worry that such tax competition is encouraging a race to the bottom. But lower corporate taxes ought to benefit everybody, by fostering investment and growth. Ultimately, firms pay for their taxes in reduced wages and jobs, so higher corporate taxes hurt honest workers the most. There is even a good argument that workers would do best if the corporate-tax rate were zero. Nor need taxing companies less stop the government, should it so wish, from taking an extra pound of flesh from the shareholders who own companies.

Alas, all this is lost in the shouting-match. Politicians are getting far too much mileage out of demonising firms and their tax advisers. What chance does sensible corporate-tax policy stand when even “moderate” Republicans such as Mr Grassley are busy stoking the fires of class war?

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War and Iraq

The economic risks

Feb 20th 2003
From The Economist print edition

Getty

Last weekend, American shop shelves were cleared of drinking water and duct tape. What next?

Get article background

“IRAQNOPHOBIA”—fear of the consequences of a probable war with Iraq—is being blamed for the sick state of the world economy and for the fall this year in the dollar and in most big stockmarkets. If fear is to blame, then a short, successful war should remove the uncertainty that is holding back consumer and corporate spending, allowing economic activity and share prices to bounce back again. Alan Greenspan, the chairman of America's Federal Reserve, appeared to suggest as much last week. But Iraq is only one of the problems facing the global economy. Others will continue to weigh it down even after the tanks and bombers have gone home.

An American-led attack on Iraq looks highly likely. But trying to assess the economic consequences of such an attack is tricky because of the vast number of unknowns and contingencies. For instance, how long will the conflict last? Will it escalate outside Iraq? Will there be any damage to oilfields, as there was in the Gulf war in 1991? Will other OPEC countries increase their oil production to compensate? And how badly will business and consumer confidence be hit? These are not questions that can be answered by plugging numbers into a computer model. Yet several investment banks and think-tanks have made a stab at it.

Most of them maintain that the likeliest scenario is a short, successful war. Oil prices would spike briefly at around $40 a barrel, but then plunge as the war ends. In turn, share prices and the dollar will rally, and confidence will revive, spurring a strong economic recovery. Several economists reckon that a war might actually be good for the world economy: it will eliminate today's mood of uncertainty, boost government spending, and push oil prices lower in the medium term as new Iraqi production comes on stream.

John Llewellyn, chief economist at Lehman Brothers, is much less sanguine. He argues that the risks to the global economy, taken together, are now greater than at any time since the 1973-74 oil crisis. Even if the war goes well, he argues, it will probably not be the panacea that investors are hoping for. The aftermath of war will be uncertain; the risk of terrorist acts will remain; and there are plenty of other worries too, not least over North Korea.

The cost of fighting

The economic costs of a war can be broken into three types. First, there are the direct military costs. The six-week Gulf war in 1991 cost $80 billion in today's prices (most of it paid for by America's allies). Assuming a similarly short war, America's Congressional Budget Office and the House Budget Committee have both estimated a total military cost of around $50 billion, or 0.5% of America's GDP. Others reckon that a more protracted war could cost America as much as $150 billion.

Second, there are the potentially far larger indirect costs of peacekeeping, humanitarian assistance and reconstruction. William Nordhaus, an economist at Yale University, thinks that these could cost America between $100 billion and $600 billion over the next decade*.

Last but not least, there are the macroeconomic costs of lost output. Especially if the war goes badly, these could be far bigger than the others, which are really just efficiency losses from the diversion of resources. Mr Nordhaus estimates that the total cost of a war to America could range between $100 billion and $1.9 trillion, spread over a ten-year period. That could be as much as 2% of American GDP for every year of the decade.

The hardest of the three to pin down is the macroeconomic cost—to the world economy, not just America's. Broadly speaking, a war in Iraq could affect economies through four main channels: oil prices; stockmarkets; the dollar; and business and consumer confidence.

Oil prices have already reached their highest level for two years. West Texas Intermediate has risen above $36 a barrel, up almost 50% from last June. So far, though, this is a much smaller rise than in the run-up to the 1991 war. In real terms, oil prices today are less than half their 1980 peak. The conventional wisdom is that prices will fall sharply once a war is over, just as they did in 1991. Then they fell from over $40 to below pre-war levels after the ground war had begun. Optimists today argue that a victory will liberate Iraqi oil as well as its people. (This assumes that the Iraqis do not sabotage their own oilfields or those of their neighbours.)

So it is widely hoped that oil prices might this time also fall towards $20 a barrel once war is under way. But is 1990-91 the appropriate model? Even if the war is as short, oil prices may not fall as much this time because the background environment is different. Economists at Goldman Sachs argue that the recent rise in oil prices has had more to do with the disruptions in Venezuela than with worries about Iraq.

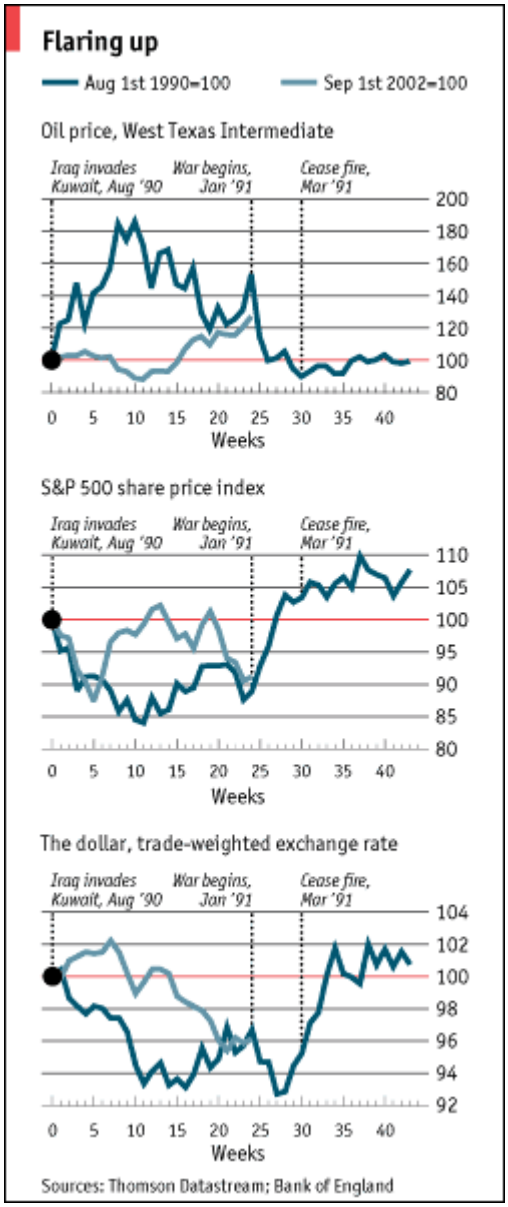
Venezuela's oil-industry strike may be over, but the country is unlikely to restore more than two-thirds of its output this year. Goldman Sachs reckons that the combined impact of Venezuelan and Iraqi disruption has the potential to be the biggest shock in oil-market history, even after allowing for some offsetting increases in supply from other producers.

Another reason why oil prices may not fall as sharply as in 1991 is that the oil market is much tighter. An exceptionally cold winter right across the northern hemisphere has boosted demand at a time when American oil stocks are at their lowest level since 1975. In 1991, oil stocks were well above normal.

OPEC also has less spare oil-production capacity this time to fill the gap. The cartel had spare capacity of 6m barrels a day when Iraq invaded Kuwait in 1990, compared with only 2m today. The continuing shortfall in Venezuela, plus even a small loss of output from Iraq, could rapidly exhaust that. In any case, Iraq will not be able to turn its oil taps on fully the moment that war ends. Goldman Sachs estimates, therefore, that oil prices may average no lower than $27 over the next 12 months.

Although the rich world uses half as much oil per dollar of GDP as it did in the 1970s, higher oil prices still have the power to hurt its

economy. According to the IMF's ready reckoner,a $10 increase in oil prices, if sustained for a year, reduces global GDP by 0.6% after one year. That impact sounds fairly modest, but the snag with all such calculations is that they consider only first-round effects. They ignore the potentially much bigger impact on confidence and stockmarkets, and they ignore the effects that follow from changes in monetary and fiscal policy.



Consistent underestimation

Even taking account of such factors, however, most forecasters still reckon that the American economy will slip into a new recession only if there is a more prolonged war, a much sharper rise in oil prices than now expected, and a stockmarket slump of at least 20%. Yet in the past, economists have consistently underestimated the economic impact of oil shocks.

Over the past three decades, oil prices have jumped sharply on four occasions: in 1973, after the first OPEC embargo; in 1979, after the Iranian revolution; in 1990, after Iraq's invasion of Kuwait; and in 1999-2000 as the world economy boomed and OPEC cut its production. Each time the price more than tripled, contributing to a global recession.

Higher oil prices hurt the economy in two ways. In the first place, the increase acts like a tax, raising firms' costs for any given output price. So if demand is unchanged, prices rise and firms produce less. Secondly, higher oil prices transfer income from oil-importing countries to oil producers, squeezing spending in the oil importers. In the economic jargon, both the aggregate demand and aggregate supply curves shift backwards. Output falls, but the impact on underlying inflation, and hence the appropriate policy response from central banks, is uncertain.

Whether central banks should raise interest rates to curb inflation, or cut rates to cushion output, depends on the cyclical position of the economy. The four previous oil shocks all took place during booms, when economies were already overheating and inflation was rising. This forced central banks to raise interest rates.

Today, the rise in oil prices is occurring in an environment of excess capacity and falling inflation. Firms have little pricing power, so it is harder for them to pass on higher costs. Rising oil prices are therefore more likely to erode profits than to push up inflation. That, in turn, would further delay a recovery in corporate investment and hiring. The correct response at such a time is to reduce interest rates, not raise them.

The Fed seems to understand this better than the European Central Bank, which frets more about its inflation target. But with interest rates at 1.25%, the Fed has little room to cut further. Euro-area rates (at 2.75%) leave more room to cut, but the ECB is likely to be slow to act. At its most recent press conference (earlier this month) its president, Wim Duisenberg, declared that “a rate cut now would be a mere drop that would drown in the sea of uncertainties”, referring to oil prices and geopolitical risks. Yet Germany, the euro area's biggest economy, may be back in recession again. The Bundesbank confirmed this week that German GDP fell slightly in the fourth quarter of 2002. And many private-sector economists reckon that output will shrink again in the current quarter.

Bubble trouble

America has more room to ease fiscal policy. Indeed, a successful war will help George Bush to get congressional approval for his tax cuts. On the other hand, Japan (thanks to its already hefty public debts) and the euro area (thanks to its stability pact) have little room to ease policy, even in the event of a further downturn.

Underpinning the hope of a strong economic rebound after a war is the unstated assumption that America's economic fundamentals are sound. However, America has yet to complete its post-bubble adjustment. Record consumer debt leaves the economy vulnerable to shocks. American consumer confidence is at a nine-year low. Some blame this on the threat of war (in which case confidence could later rebound). But, in fact, more of it may be due to consumers' heavy debts, poor underlying job prospects, and falling stockmarkets.

Economists are using war fears as a convenient explanation for slower than expected growth—just as they (wrongly) blamed America's recession in 2001 on the September 11th attacks. Bill Dudley, an economist at Goldman Sachs, argues that war fears are not the biggest reason why the economy is soft. Instead, the problems lie deeper: in the excesses built up during the bubble years, such as huge private-sector debts, excess capacity, low saving, and a massive current-account deficit.

America's over-indebted households, Japan's deflation and its crippled banks, Europe's structural rigidities and its overly tight fiscal and monetary policies: all these mean that the world economy is horribly vulnerable to shocks of any kind. Moreover, after the Gulf war America's initial recovery was sluggish, due to the need for firms to reduce their debts from the excesses of the 1980s. Yet the excesses of the 1990s were much larger. America's fragile economy is, in a manner of speaking, being held together by duct tape. The 1.3% jump in retail sales (excluding cars and petrol) in January may partly reflect precautionary stockpiling of canned foods, bottled water and other goods.

Trading blows

Most stockmarkets have fallen in each of the past three years, and many investors are hoping that getting the war out of the way will stop the rot. Between the start and finish of the Korean war, American share prices rose by 28%. In 1991, the S&P 500 rose by more than 20% within four months of the start of the air attack.

But America's stockmarkets looked cheaper in 1991 than they do today. A market with a p/e ratio of 28 on historic profits, and an average forecast of double-digit profit growth despite slow nominal GDP growth, is not exactly discounting bad news. Another big difference from 1991 is that analysts have already assumed a quick and painless war. Before the Gulf war they were much less confident. So the downside risk today is much greater. A prolonged war could drive property and share prices sharply lower.

How might exchange rates react? The sharp fall in the dollar in recent months may in part be related to war worries. So a quick victory, it is argued, would help the dollar to rally. The dollar bounced by 10% in trade-weighted terms within two months of the end of the Gulf war.

However, there is a big difference this time. In 1990-91 the net cost of the war to America was reduced from $80 billion, at today's prices, to only $4 billion after contributions from friendly Arab countries and Japan. These transfer payments flattered America's current-account balance in 1991 and so helped to lift the dollar. This time, America will have to foot most of the bill itself. In 1991, it had a small current-account surplus. Today, with its deficit running at more than 5% of GDP, any dollar recovery is likely to be short-lived.

Beyond the macroeconomic fall-out from war, there is one other big concern: that diplomatic tensions between America and Europe over Iraq could spread beyond war to trade. The two sides already have a string of bilateral trade disputes: over America's steel tariffs and its tax breaks for foreign sales by big multinationals; and over the EU's ban on imports of hormone-treated beef and genetically-modified foods, for instance.

German firms are particularly worried about a loss of business in America. Last week, the American Chamber of Commerce in Germany celebrated its 100th anniversary. In between the champagne and canapés there was much talk that the political rift between the two countries could harm commercial links. A few American congressmen have already called for restrictions to be imposed on the import of European wine, cheese and military equipment.

There is also talk that American firms might shift their future investments from “old Europe”—France and Germany—into “new European” countries—such as Britain. More realistically, however, Germany and France are already seen as hostile business environments because of their high labour costs and taxes, and their rigid markets. To some extent, the political rift is just another excuse.

What is clear, however, is that the spat over Iraq will not help to speed up trade negotiations in the Doha round, which already seem to be heading for gridlock. Last weekend, trade ministers meeting in Tokyo made almost no progress towards liberalising farm trade. Yet agriculture is the central issue for the Doha round. Failure to liberalise farm trade would be a big blow to the poor world. Even worse would be an associated tit-for-tat trade battle between the rich.

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* “The Economic Consequences of a War with Iraq”. American Academy of Arts and Sciences, December 2002. Available at www.amacad.org/publications /monographs/War_with_Iraq.pdf (see chapter three)

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The cost of war

Unimaginable

Feb 20th 2003
From The Economist print edition

Governments tend to underestimate the bill

Get article background

AMERICA'S most expensive war—in terms of lives as well as budgets—was the second world war. It cost the American taxpayer a massive $2.9 trillion (in today's prices), or 130% of the GDP at the time. In contrast, the war in Vietnam cost a mere 12% of GDP, and official forecasts for the cost to America of this Iraq war are only 0.5% of its GDP.

War chests
Cost to the US of major wars

Conflict	Direct cost of war, $bn 2002 prices	As % of GDP*
Revolutionary war (1775-83)	2.2	63
War of 1812 (1812-15)	1.1	13
Mexican war (1846-48)	1.6	3
Civil war (1861-65)	62.0	104
Spanish-American war (1898)	9.6	3
First world war (1917-18)	190.6	24
Second world war (1941-45)	2,896.3	130
Korean war (1950-53)	335.9	15
Vietnam war (1964-72)	494.3	12
Gulf war (1990-91)	76.1	1

*At time of the war

Sources: William D. Nordhaus, Yale University; Al Nofi, Statistical Summary: America's Major Wars, www.cwc.lsu.edu/cwc/other/stats/warcost.htm

History shows that governments consistently underestimate the cost of their battles. Abraham Lincoln's treasury secretary estimated that the direct budgetary cost of the civil war to the northern states would be about 7% of their GDP at the time. The actual cost ultimately turned out to be 12 times as much. The cost to the southern states, incidentally, was even more.

In more recent times, the Pentagon grossly underestimated the bill for the war in Vietnam, which ended up being about ten times the size of the original estimate. William Nordhaus, an economist at Yale University, suggests that wars are disproportionately undertaken by governments that overestimate their chances of victory or underestimate the size of the job.

Saddam Hussein is clearly not accounting for his warmongering. On one estimate, the Iran-Iraq war, the Gulf war and the subsequent economic sanctions have cost Iraq something of the order of two decades-worth of GDP. (This is based on a wide definition of cost, which includes the loss of output and the destruction of capital stock, as well as the military burden on the budget.) That may well be the biggest such economic devastation in modern history.

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German banks

That sinking feeling

Feb 20th 2003
From The Economist print edition

There is no quick way out of the quagmire for Germany's banks

"THE worst is behind us," declared a bold Dieter Rampl on February 19th. Maybe. HVB Group, Germany's second-biggest bank, could at least point to a decent operating result in the fourth quarter of 2002: a profit of *euro*1.1 billion ($1.1 billion). But that was more than wiped out by provisions against bad loans. In the year as a whole, HVB lost more than *euro*800m, set aside *euro*3.8 billion against dud loans, and scrapped its dividend in order to shore up its capital base.

Mr Rampl, "spokesman" of HVB's management board—in effect, its chief executive—is scarcely alone among German bank bosses in having to report dreadful results. In the past couple of weeks Commerzbank, Germany's number-four bank, has also reported its first-ever full-year loss. Soon Allianz, a big insurer, will confirm just how bad 2002 was for Dresdner Bank, the country's third-biggest bank, which it bought in 2001.

At Deutsche Bank, by far Germany's largest, the outlook is a bit more optimistic. After years of relying on its investment bankers for profits, the bank seems at last to be knocking its underperforming retail-banking and asset-management division into shape. It is stripping itself down, ditching much of its private-equity portfolio and passive asset-management. It is getting rid of many of its holdings in German companies, from Munich Re, a big re-insurer, to Südzucker, a sugar producer. Sales of these stakes, long a fixture of German capitalism, raised a much-needed *euro*3.7 billion last year.

For all that, Deutsche is far from fighting fit. Its cost-income ratio, a standard measure of efficiency, is a flabby 83%. And it has just suffered a double blow, of so far uncertain severity. On February 17th, it emerged that the spokesman of its management board, Josef Ackermann, had been charged, with five others, in connection with the takeover of Mannesmann, a German conglomerate, by Britain's Vodafone in 2000 (see article). And the next day a Munich court ruled that Deutsche and Rolf Breuer, Mr Ackermann's predecessor, who now chairs the bank's supervisory board, were liable to pay damages to Leo Kirch, a media mogul whose empire crumbled last year. Mr Breuer had cast aspersions on the creditworthiness of Mr Kirch—a client, albeit a heavily indebted one. If the verdict is upheld, it could cost Deutsche hundreds of millions of euros and Mr Breuer his post.

The whims of the German legal system apart, there are three main reasons why the country's banks are in such a mess. The first is the state of the economy, which Germany's six leading economics institutes

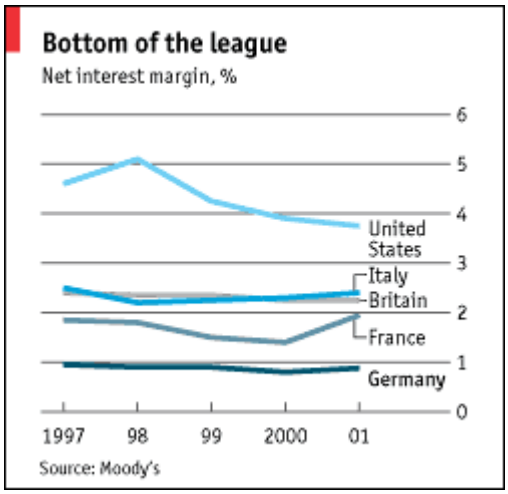
said this week may well be in recession again. Last year saw a record number of bankruptcies: as well as thousands of small firms, household names, such as Mr Kirch's companies, Babcock Borsig, an engineering firm, and Herlitz, a stationery maker, were brought down. This has forced banks to increase their bad-loan provisions. Meanwhile, the fall in Germany's stockmarket, which last year was steeper than in any other big, rich economy, has cut the value of their remaining industrial holdings, taking the stuffing out of an old cushion against hard conditions.

The second reason is that the banks are counting the cost of past mistakes which they are now trying to put right. For example, as capital markets boomed in the late 1990s, they poured resources into investment banking. Only Deutsche made a decent fist of it. The investment-banking arms of Dresdner and Commerzbank, being smaller, suffered more when the good times ended and are now being scaled back to focus on Europe. Dresdner's investment bank would be an obvious candidate for sale, were there a buyer.

This might suggest that recovery—if it comes—and measures being taken to slash costs and reorient their businesses will be enough to return Germany's banks to health. Alas, it may not, thanks to the third reason for the banks' malaise: the fragmented structure of Germany's domestic banking market.

Unlike their British or French counterparts, Germany's big private banks have only a small retail franchise. Between them, they have less than 4% of the money in Germans' savings accounts and make only 14% of all loans to companies and households. The country's 520 mainly municipally owned *Sparkassen*, or savings banks, have more than half of all savings deposits and make 20% of loans; the 12 *Landesbanken*, regional banks owned by a mixture of federal states and associations of *Sparkassen*, have about 16% of the lending market. Taken as a group, Germany's roughly 1,500 co-operative banks also have a big market share.

Being in public ownership, the *Sparkassen* are less bothered than the big banks about profitability. Supporting local businesses matters at least as much to them. Those savings deposits give them a deep pool of cheap funding. The *Landesbanken* are not only similarly motivated, but enjoy, for now, state guarantees. All this means low funding costs for the public-sector banks—and historically thin margins for the private banks (see chart).



Under pressure from the European Commission, the *Landesbanken* are due to lose their guarantees, starting in 2005. This ought to make life easier for the private banks. Yet it might not. Public-sector owners may stand behind their banks anyway, even if they do not say so explicitly. Both *Landesbanken* and *Sparkassen* will keep their public-service ethos.

Sometimes consolidation, especially between HVB and Commerzbank, is touted as the way for private banks to climb out of the muck. But any such merger would not help much now: it would merely turn two weak banks into one bigger one. Private-sector mergers might never help much. Deals across the public-private divide, now almost unthinkable, would do far more good. Commerzbank's chief executive, Klaus-Peter Müller, once mused aloud that he “would like to buy a *Sparkasse*.” That would be no bad idea—if he has the chance.

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Outsourcing to India

Backroom deals

Feb 20th 2003 | CHENNAI AND DELHI
From The Economist print edition

India aims to become the back office for the world's banks

POOR as it is, India is rich in well-educated, English-speaking, young people. It has become a prodigious exporter of their remote services: as skilled software coders and accentless call-centre voices; as long-distance sales-people and invisible insurance clerks; as diligent medical-record transcribers and patient number-crunchers. Multinational financial firms have been among their best customers. Now India wants to clamber up the value chain, offering more sophisticated services. Finance, a business that runs the gamut of sophistication from bean-counting to quantum physics, seems as good an industry as any in which to try to lure more work from expensive homelands to cheaper Indian pastures.

The bulk of that work—by value, at least—is still in information technology. Sunil Mehta, vice-president of Nasscom, the industry's trade association, says that in 2002 global financial institutions spent $120 billion on IT, of which only $4 billion was outsourced to India. He sees a big opportunity for Indian software companies in banks' drive towards more seamless processing of transactions, and in the closer scrutiny of back-office costs inspired by moves towards a new international capital-adequacy regime. Indian firms such as TCS, Wipro and Infosys already carry out a lot of some banks' IT operations; another firm, i-flex solutions, sells its banking-software product, “flexcube”, in more than 50 countries.

Besides software engineers, India also has millions of other bright young professionals: accountants, lawyers and business-studies graduates. They have already attracted plenty of IT-enabled work from financial firms. To take but a few: GE Capital International Services, which describes itself as the “largest shared-services environment in India”, employs more than 13,000 people in activities ranging from finance and accounting to remote marketing; Citigroup's outsourcing arm, e-Serve, has more than 3,000 people in Mumbai and Chennai; American Express has 2,000 processing transactions from around Asia and manning a 24-hour international call-centre in Delhi; HSBC a similar number in Hyderabad, Bangalore and Pune; and even the World Bank has 100 staff in Chennai.

Many firms are gradually transferring more complex processes to India. Scope, the outsourcing arm of Standard Chartered, the largest foreign bank in India, has the grand aim of becoming, in effect, the back office for many of the bank's operations in 56 countries. It already undertakes at least some work for 34. Unusually, Standard Chartered in Chennai even handles the back end of foreign-exchange trading—everything except the deal itself, from confirmation through to settlement—and copes with derivatives transactions as well. Some 2,000 people work in the Chennai “global processing centre”, with at least another 1,000 expected to join this year. Scope is still competing for business from within its own group. But it has begun exploring the idea of selling its services to outsiders—as has e-Serve.

Many big investment banks, accountants and consulting firms are farming work out to Indian-based subcontractors, even if they are shy about admitting it. Not only might clients worry about security and confidentiality, or feel short-changed when work is shipped abroad; the implicit threat of cuts in jobs (or pay) at head office might rattle morale. (This week, Britain's BT was under fire over plans to outsource directory inquiries to India.)

Yet increasingly, relatively humdrum, time-consuming tasks, which would once have been foisted on ambitious but inexperienced young recruits, working long hours to earn their spurs in Wall Street or the City of London, are, thanks to the miracle of fibre-optic cable, foisted on their lower-paid Indian counterparts. And, besides the in-house operations, there are a few independent foisters. Evalueserve, in Gurgaon near Delhi, with 100 professionals, offers research and analysis to banks, venture capitalists, consultants and others. Its much smaller neighbour, SmartAnalyst, boasts four of the top ten American investment banks as clients for its tailored internet-based research service.

A report published last year on the alarming shortfall in the pension funds of a large number of European listed companies appeared under a western brand name. The data, however, were retrieved, collated and organised on the sixth floor of the building that houses Chennai's biggest shopping centre. There, Office Tiger employs 675 young Indians providing a virtual back office to some 20 American and European firms: banks, auditors, consultants and lawyers. Having started in desktop publishing, it now offers to replicate the functions of a bank's in-house library and its junior analysts. Joseph Sigelman, an American former investment banker who runs the fast-growing outfit, estimates that, at an hourly rate of $20-35, it routinely takes out 50% of its clients' costs.

Slumping markets and regulatory troubles are helping to expand the number of services that financial institutions are contemplating outsourcing. Hard times concentrate minds on cost-saving. The hope for Indian services is that, as in the software industry, customers who came for the price will stay for the quality.

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Japanese consumer finance

Still in the stratosphere

Feb 20th 2003 | TOKYO
From The Economist print edition

Are Japan's consumer-finance firms about to be brought back to earth?

Get article background

EXTRA-TERRESTRIALS and a pensive chihuahua partly explain the success of two of Japan's consumer-finance firms. The second-biggest, Acom, started using the aliens in 1996 in a TV advertisement for new unmanned loan-application booths. That year, it pulled in 47% more new customers than in 1995. Although the campaign has been discontinued, Acom's brand remains strong. The chihuahua is helping Aiful, the fourth-largest firm, to increase its share of new loans. Sales of chihuahuas have risen sharply too.

This cuddlier image has helped to dispel nasty memories of the 1970s and 1980s, when Japan's personal-loan industry was a byword for exorbitant interest rates and aggressive collection methods. Since the early 1990s, the industry has been a rare success story in Japan's bleak financial-services market. The value of outstanding loans has risen at a double-digit pace and now stands at ¥12 trillion ($100 billion). Consumer loans dominate turf that is shared in other rich countries with overdrafts and credit-card debt. In Japan, overdrafts are practically unheard of, and the consumer-finance market is almost six times bigger than the growing but underdeveloped credit-card market.

There are fat profits to be made, even though the maximum interest rate that consumer-finance firms may charge was cut from 40% to 29% in 2000. Most charge about 25%; in deflationary Japan, their own financing costs are, on average, a mere 2%. Keen to win a piece of such a lucrative pie, foreign groups, such as America's Citigroup and GE Capital, have been buying into Japan's personal-loan market. Citigroup is now thought to have over ¥1.5 trillion of outstanding loans, close behind Takefuji, the market leader, and Acom.

Entrants to the market envy incumbents' jealously guarded database of pooled credit information about their customers (Japan has no national credit register). The top consumer-finance firms have sophisticated risk-management systems—and could teach the banks a thing or two about managing credit risk, says Jason Rogers of Barclays Capital in Tokyo. Indeed, some banks are forming joint consumer-finance ventures with the leading firms.

Yet the outlook for the industry is looking cloudier. As the economy continues to slide, personal bankruptcies have soared. According to figures released this month by the Supreme Court, more than 214,000 people filed for bankruptcy in 2002, one-third more than the year before and five times as many as a decade ago (see chart). These days the top firms are writing off 5% of their loans, twice the rate of three years ago. Dean Perry of ING, a Dutch bank, believes the figure could rise to as high as 8% within a year or so. With demand too weak to make up for the shortfall, he thinks total outstanding loans could fall by one-fifth in the next three to five years.

But what really alarms the personal-loan industry is that regulators might cut the maximum rate of interest (and with it their profit margins) when it is reviewed in June. Some politicians want the ceiling to be trimmed to around 20%, the maximum banks are allowed to charge. Few observers expect the rate to be cut that much, if at all. Still, the prospect has provoked fierce opposition from local consumer-finance firms and from the American Chamber of Commerce in Japan, whose members include Citigroup and GE Capital.

The companies argue that a rate cut would hamper consumer borrowing and thus spending, further weakening the economy. Customers now at the margin of acceptable riskiness, such as over-stretched consumers, they claim, would be denied credit altogether. Yes, but for customers who remain, lower interest rates should encourage more borrowing.

Opponents of a cut also say that riskier borrowers might turn to loan sharks, whose rates range from 100% to 1,000%. One was caught charging 170,000% last year. That loan sharks are becoming more active—police statistics show a record number of victims last year—worries consumer-finance firms, who fear their reputation and business could suffer too. Already, a TV-industry watchdog, concerned that young people are borrowing too easily, is campaigning for a cut in the number of consumer-finance advertisements during prime time. Given the selling power of aliens and chihuahuas, this could be the severest blow of all.

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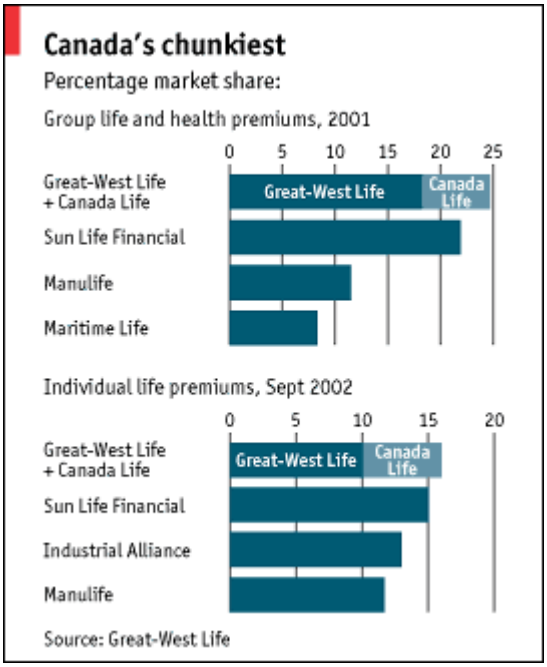
Canadian insurance

Life on the prairie

Feb 20th 2003 | TORONTO
From The Economist print edition

An agreed takeover bid should create Canada's biggest insurer

THE temperature in Winnipeg touched -27°C this week. Not even that could freeze the biggest business transaction ever in the prairie city. Great-West Life, an insurance company based in Winnipeg, offered C$7.3 billion ($4.8 billion) for its rival, Canada Life. The deal will make Great-West Canada's largest insurer, pushing it past Sun Life of Canada.



Great-West's offer of C$44.50 a share trumped a C$40 bid from Manulife Financial, often regarded as the most aggressive company in Canadian insurance. Still, Dominic D'Alessandro, Manulife's chief executive, should make a profit of C$300m on the 9.1% stake that his firm had built up in Canada Life.

Consolidation among Canada's insurers has now gone about as far as it can. If there are to be more takeovers, insurers will have to look at targets in the United States, or at banks at home. Last year the federal government put a stop to a mooted merger between Manulife and Canadian Imperial Bank of Commerce (CIBC), the country's second-biggest bank by assets. Mr D'Alessandro may now try again with one or other of Canada's top six banks.

Great-West's ultimate owners, the Desmarais family, are also thought to be interested in moving beyond insurance and into banking. The patriarch, Paul Desmarais, already controls Investors Group, the country's largest mutual-fund company, through his main vehicle, Power Financial Corporation, and through a series of holding companies.

In the past, mergers between insurers have proved far easier than those between banks. In 1998 the federal government turned down two bank mergers, one between Royal Bank of Canada and Bank of Montreal, and the other between Toronto-Dominion Bank and CIBC.

The government held hearings earlier this year on bank mergers, which politicians are still reluctant to allow. Voters moan about branch closures and possible increases in service charges. As things stand, however, Canadian bank charges are lower than those in the United States, and the unified Canadian clearing system is more efficient than America's.

Mergers between banks and insurers might be more acceptable to the politicians, and give the financial companies the scale they seek—even though the mixed experiences of European banking-and-insurance hybrids ought perhaps to give them pause for thought. And politically, as it happens, Mr Desmarais could scarcely be better connected. One of his sons is married to the daughter of Jean Chrétien, the prime minister. And when Mr Chrétien retires next year, his successor is likely to be Paul Martin, the finance minister who turned down those bank mergers five years ago—and a former vice-president at Power Financial Corporation.

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Medical-malpractice insurance

A suitable case for treatment

Feb 20th 2003 | NEW YORK
From The Economist print edition

Doctors protest against high insurance costs—and so do insurers

A COUPLE of weeks ago, doctors briefly walked out in New Jersey. The week before, it was in Florida, the month before in West Virginia. Other strikes have either occurred, or been seriously threatened, in Pennsylvania, Nevada, Texas and at least seven other states. In each case, the complaint has been the same: huge increases in the cost of malpractice insurance.

Certainly, premiums have rocketed. For the most affected procedures, concerned with childbirth, complex surgery and cancer detection, double-digit annual increases are common. In some cases rates have doubled or tripled. Predictably, consumer groups are lambasting insurance companies for their greed. In fact, insurers are as disillusioned as doctors.

The results of malpractice insurers are abysmal. In the rest of the property-and-casualty industry, insurers paid out around $1.06 last year for every dollar of premiums received, a mediocre performance by past standards. In malpractice, A.M. Best, an insurance rating-agency, expects companies to have paid out $1.41 per dollar received. It is small consolation that the business is improving: in 2001, insurers had to shell out a staggering $1.53. In the past year, A.M. Best has downgraded the claims-paying ability of half a dozen small firms below what it calls secure, a level that many doctors consider a prudent benchmark. The outlook, says the agency, is more of the same.

The result is that it is increasingly hard for doctors to find insurance. Two years ago, America's second-largest malpractice underwriter, St Paul, created a stir by announcing that it would pull out of the malpractice business altogether. General Electric is suspected of a similar ambition. Its insurance arm, which ranked just behind St Paul in malpractice, is widely believed to be up for sale. Other firms are having the decision made for them. MIIX, which was the 15th-largest malpractice insurer when St Paul made its announcement, has since gone into liquidation. In Florida, the number of underwriters of malpractice insurance has fallen in three years from 66 to 12.

Trial lawyers and various civic groups blame the losses and the huge rate increases on underpricing during the 1990s. Fine, but if today's high premiums were just an attempt to make up for past mistakes, there would be new entrants into the business. If there are any, they are keeping quiet about it.

Insurers have their own familiar complaint: spiralling jury verdicts, particularly for non-economic damages, called pain and suffering. According to *Jury Verdict Research*, a trade publication, the median award for malpractice reached $1m in 2000, up by 43% from 1999 and twice as much as in 1995. The trend may change. Some states, notably California, have capped punitive-damages awards. And in his state-of-the-union address, President Bush urged Congress to place a ceiling of $250,000 on damages, as part of a broad medical-liability reform. Congress has held hearings on medical litigation, and a bill may be drafted this year. But limiting Americans' right to sue or to collect millions in damages will not be easy.

Meanwhile, the market is reacting predictably. There is growing anecdotal evidence that, in states with very high insurance costs, doctors are choosing not to practise. The American College of Obstetricians and Gynaecologists, a trade group, has compiled a list of such states: doctors are giving up and one hospital has been forced, after more than a century, to close its maternity ward. This market needs healing, fast.

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About sponsorship

Banking for immigrants

Reaching out

Feb 20th 2003 | CHICAGO
From The Economist print edition

America's banks make new efforts to serve those they have hitherto ignored

AP

Next time, mommy, can we go to the bank?

HOW many bankers would take the kind of leap James Maloney has done? The chief executive of Mitchell Bank, a family-owned institution on the south side of Milwaukee, has plunged into one of the least banked groups in America: immigrant teenagers. For the past three years, Mitchell Bank has operated a full-service branch inside South Division high school, located in a low-income district of largely Hispanic immigrants. The branch, which is run by students who earn credit towards graduation requirements while working under adult supervision, has been so successful that many students' parents now deposit their pay cheques there. At least 90% of the customers have never had bank accounts.

Nobody knows how many Americans lack access to bank services, but the Treasury puts the number at more than 35m. Whereas many of the rural poor and minorities in inner cities have been “unbanked” for reasons ranging from lack of education to bad credit, the wave of hard-working immigrants who have arrived in the past decade, primarily Hispanics, has financial-services firms salivating. Their growing economic clout (about $24 billion of remittances were sent to Latin America last year) has spurred many new bank services and marketing programmes.

Large institutions, including Wells Fargo, Citibank and Bank One, are now following the trail blazed by the likes of Mr Maloney, although they tend to be more cautious and many are reluctant to publish broken-out results. Several large banks now offer “payroll card” programmes to employers, who can put funds directly into the accounts of employees, typically teenagers or immigrants. The employees may not write cheques, but instead use special debit cards, co-branded by Visa, which allow instant verification that funds are available. This limits the bank's risk.

Dual ATM cards, which allow a party in America to deposit funds that can be withdrawn by a recipient abroad, are also now available, as an alternative to more expensive wire-transfer services. In a tacit acknowledgment of the millions of illegal immigrants in America, numerous banks accept the *matricula consular*, a card issued by Mexican consulates regardless of the applicant's legal status, as sufficient identification to open a bank account. And designated community banks, such as First Bank of the Americas in the heart of Chicago's Hispanic district, are supported by the Treasury when they offer low-cost services, such as basic loans, aimed at previously unserved populations.

While community banks are dedicated to reaching poorer people or immigrants, at larger banks decisions about whether to accept or reject such new customers can cause conflict between the marketing and

risk-control departments. “We're trying to balance accessibility with fiduciary responsibility,” says Tom Kelly, a Bank One spokesman. “We're protecting the integrity of the bank.” Typically, large banks charge higher fees to customers with small balances in their accounts.

People who remain outside the banking system often fall prey to predatory lenders and to the high charges levied by wire-transfer services, with little recourse when they are abused. “If you're undocumented, are you going to create a fuss?” asks David Schnepp, a former economic-development official who plans to launch a low-cost money-transfer service aimed at the Hispanic market later this year. He and his partners intend to create an alternative to Western Union, which dominates the $122 billion international wire-transfer market. He plans to work with community groups, which will get a share of the profits. Many banks have also eyed the wire-transfer market with envy, but Western Union has fought back by opening a slew of new outlets in recent years.

Lack of trust in financial institutions remains a big hurdle for many of the unbanked. Hence the push by Mr Maloney's bank and others to build ties with trusted community organisations, such as schools or social clubs. First Bank of the Americas, for instance, has linked up with churches serving immigrants. It sponsors a Spanish-speaking marketing consultant, who addresses churchgoers about the dangers of predatory lending and the benefits of using institutions recommended by their church or community leaders.

The government has played a growing role in the push to reach America's unbanked population ever since legislation requiring all federal payments to be made electronically exposed the huge number of people without bank accounts several years ago. Last year the Treasury's newly created Office of Financial Education launched a pilot programme, called First Accounts and operating in 26 states, that aims to bring 35,000 people into the banking system for the first time.

Mr Schnepp emphasises that ultimately, the integration of America's unbanked population is in the broader interest. “A rich community buys goods, a poor community is a drain,” he says. “This is not about charity.”

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Economics focus

A question of trust

Feb 20th 2003
From The Economist print edition

Economists are arguing about "social capital"—starting with what it means

WHAT gives rise to the wealth of nations? Some see the source in rich seams of mineral resources such as oil or coal. Geography matters too: countries in temperate climes tend to be richer, other things being equal, than those closer to the equator. Then there are institutions: the rule of law and (perhaps) democracy. Above these, most economists since Adam Smith have believed, stands the invisible hand of the market, guiding selfish human actions to serve the common good.

Is there something missing from the list? For the past decade or so, sociologists have been pushing one more concept, "social capital"—trust or community, in one of its guises—that is now also being taken up by economists. Crudely speaking, the more people trust each other, the better off their society. They might work more efficiently together, for example. In business, trust might obviate the need for complicated contracts, and thus save on lawyers' fees. You might expect that America, which has such a successful economy, had social capital in shedloads. Maybe, and maybe not: one of the most influential essays in the field, "Bowling Alone", by Robert Putnam of Harvard University, pointed out that Americans were far less likely to be members of community organisations, clubs or associations in the 1990s than they were in the 1950s. He illustrated his thesis by charting the decline of bowling leagues.

A recent set of articles in the *Economic Journal** shows how economists are grappling to analyse social capital. On the face of it, the idea that trust or community can make a difference between wealth and poverty does not fit easily with the basic assumption of orthodox economic theory: that humans are essentially self-interested animals. That is why it has an instinctive appeal to "behavioural" economists, who think that this assumption has been accepted too uncritically.

In one paper, Samuel Bowles and Herbert Gintis, of the University of Massachusetts, advance just such a view. They argue that, if social capital is taken into account, economists have to put aside the idea that people are simple, self-interested economic machines. People donate their time to all sorts of things, from voting to teaching in Sunday school, whose costs outweigh the private benefits. Obviously, argue Mr Bowles and Mr Gintis, humans are social animals.

This could be explained away easily, though, by making the assumption that people derive utility from helping others at their own expense. But the authors think that something more sophisticated is required. They carried out experiments, using university students, to see how a group of people might encourage each other to act in the interests of the group as a whole. Many subjects, it seems, take pleasure in punishing free-riders. Many respond to the shame of being found out as shirkers, which encourages co-operation. The lesson is that notions of selfish, or indeed altruistic, preferences cannot explain the incentives of people in a village, school or parish. The authors conclude that such communities are the missing ingredient, alongside markets and the state, in understanding an economy.

No, it does not take a village

In another paper, Edward Glaeser and David Laibson of Harvard University and Bruce Sacerdote of Dartmouth College take individuals, not groups, as their starting point. They also use a more individualist definition of social capital: a person's social skills. This can mean a long list of contacts, a facility for dealing with others, or even just charisma. The authors include popularity in their definition, since it can be the result of investing in personal relationships. They measure people's stock of social capital by the number of organisations—clubs, charities, religious groups and so forth—to which they belong.

The authors see social capital as something that people can build for themselves, rather as they build financial wealth by saving or investing, or “human capital” by acquiring skills and education. A doctor, for example, might invest in more than just medical education: by joining a local club, she could get to know her patients better and perhaps increase her future income.

Messrs Glaeser, Laibson and Sacerdote find that investment in social capital, as they define it, has similar characteristics to investment in financial or human capital. People join professional societies, say, when they are young and reap the benefits when they are older, relying on business contacts made early on, just as they do with savings. People also invest more in social capital the more likely they are to remain living in the same place; the “bowling alone” phenomenon may be partly attributed to rising mobility. They also invest more in social capital the more they stand to gain from it. When there is nothing in it for them, they neglect their neighbours. *Homo economicus* lives.

By definition, however, decisions to invest in social capital affect not just the individuals making them but others too. It is tempting, if social capital is defined in terms of community or trust, to see such spillovers as always positive. But they may not be. For instance, if people act in the interests of a group to which they belong, others can be harmed: a professional association, for example, may keep fees and entry barriers high, or some groups may exclude outsiders altogether.

In the final paper in the series, Steven Durlauf of the University of Wisconsin says that research into social capital may have become a bit too other-worldly. Existing data, mostly taken from surveys, are not up to the task of specifying social capital precisely enough. Perhaps too much has been invested in the concept of social capital to help explain why nations become wealthy. As more economists pile into this fertile area, expect more deflation of the concept—and also more argument.

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*Volume 112, Number 483, November 2002

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About sponsorship

The Marjorie Deane internship

Feb 20th 2003
From The Economist print edition

Applications are invited for the 2003 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a would-be or junior journalist under 28, who will spend three months of the summer at *The Economist*, writing about finance. Applicants should send a letter introducing themselves, with an original article of about 1,000 words intended for the finance and economics section. Applications must reach us by April 7th, and should be posted to: The business affairs editor (Deane internship), *The Economist*, 25 St James's Street, London SW1A 1HG

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Evolution

Sex and the single monkey

Feb 20th 2003 | DENVER
From The Economist print edition

Ardea

Darwin's theory of sexual selection is under attack. The first of four reports (here, here and here) from this year's meeting of the American Association for the Advancement of Science

HOW the peacock got his tail is one of evolutionary biology's best-known fables. It was first told by none other than the master of evolutionary theory himself: Charles Darwin. It is, Darwin said, all down to the fickle, female peahen. Because she prefers to mate with males with the flashiest tails, large-tailed males have more offspring.

What is less well known is that this theory of sexual selection was created as something of a fudge. Darwin proposed it in response to criticism of his broader theory of evolution by natural selection. That explained how an animal (such as a giraffe) became adapted to its environment through natural variations between individuals. Different neck-lengths in giraffes may confer an advantage on those with the longest necks.

The problem with this theory, said Darwin's critics, is that it does not account for animals such as the peacock, the stag beetle and the mandrill (illustrated above), whose males have elaborate and bizarre traits. Far from being adaptations to their environment, these showy traits seem likely to be a disadvantage.

Thus, to explain variations between the sexes, Darwin put forward the theory of sexual selection. Females, he said, are the choosy sex; males compete to win female attention. Evolutionary biologists later came to believe that this difference arose from the different size of the gametes—sperm and eggs. Because female gametes are larger than male gametes, females invest more as parents in producing them and so are pickier in their choice of a mate. Males, on the other hand, produce cheap sperm and are promiscuous.

Everybody's doing it

The problem, says Patricia Gowaty, of the University of Georgia, is that the real world does not work like this. At this year's meeting of the American Association for the Advancement of Science (AAAS), in Denver, she explained that her experiments with a number of species, in particular fruit-flies and mice, show that males can be just as picky about their sexual partners as females. Joan Roughgarden, of Stanford University, points out that female monkeys often solicit males and are rebuffed. Why should this be, she asks, if sperm are so cheap?

What worries the minority of scientists who are openly challenging sexual-selection theory is that it is unable to account for much of the diversity of sexual behaviour that exists. If, for example, as sexual-selection theory assumes, mating is primarily about sperm transfer, why do some animals mate between a hundred and a thousand times more often than is needed for conception alone? For animals with strong social structures, the answer could be that mating is a public symbol with social consequences. It is used to create and maintain relationships and alliances, and also to obtain sexual gratification.

Dr Roughgarden, however, believes that the basic mistake is to think that a difference in the size of sperm and eggs translates into differences in behaviour and life history. She says that there are many ways in which animals refute the predictions of sexual selection. For one thing, some fish can make both eggs and sperm during their lifetime, so it is difficult to say categorically that an individual is male or female. Even in such fish as the blue-gilled wrasse, whose biological sex is determined at hatching, gender roles (ie, the behaviours typically associated with one sex or the other) are not.

For, besides fish that behave like “normal” males and females, there are “feminised” males—fish that look like females but have male gametes. These reproduce by helping dominant males to mate with females. In doing so, they gain more reproduction opportunities themselves.

The society of blue-gilled wrasse is by no means the most complicated in sexual terms. Animal societies with up to three male genders and two female genders have been described. Even when only two genders exist, there are cases where male choice of females is the norm. For example, sea-horse males incubate the young in a special pouch and thus provide parental investment that is worth competing for if you are female.

Most troubling, perhaps, to the theory of sexual selection, is the high incidence of homosexuality. Homosexual behaviour in animals, though well demonstrated in the literature written by scientists who actually observe what animals get up to, has tended to be glossed over by theoreticians. But Paul Vasey, a researcher at the University of Lethbridge in Alberta, Canada, has spent many years studying both theory and practice in Japanese macaques.

Female macaques often form homosexual consortships. These are temporary but exclusive relationships that involve frequent sexual activity. Females in a consortship will mount each other tens or hundreds of times. In one group that Dr Vasey observed, females mounted each other as often as once every two minutes. Yet his observations suggest these consortships serve no adaptive function. He has spent many years testing hypotheses that might explain the behaviour, such as alliance forming, the relief of social tension and the communication of dominance. There is, he says, not a shred of evidence for any of them. Female mounting behaviour may have evolutionary roots, but he reckons the reason for it now is sexual gratification. That gratification is involved is known because when a female mounts another female she thrusts her pelvis against the mountee and masturbates her clitoris using her tail.

This activity, of course, excludes males. In one study, Dr Vasey found that when male monkeys courted a female involved in a homosexual consortship, 95% of such females rebuffed him and chose to remain with their girlfriend. This suggests, he says, that it is not simply males who are competing for sexual partners, as Darwin's theory predicts, but both males and females. And homosexual behaviour is documented in at least 15 other species, including Canada geese, gorillas, chimpanzees and humans.

Such examples may not be enough to topple sexual selection, and it is likely that this part of Darwin's theory does indeed hold good for many species. But as Dr Roughgarden warns supporters of that theory, although any one of these problems with it might be overlooked, the “sheer number of difficulties is hard to deny. If these are not enough to falsify sexual-selection theory, then what would be?” Sex, it seems, has come a long way since Darwin.

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Fishing and conservation

Turtle power

Feb 20th 2003 | DENVER
From The Economist print edition

"Bycatch" from fishing is a bigger problem than was realised

Get article background

LEATHERBACK turtles swam with the plesiosaurs. They survived the catastrophe 65m years ago that wiped out not only all the other marine reptiles around, but also the dinosaurs. They faced down competition from mammals that took to the sea. But now they may have met their match. Over the past two decades, the number of Pacific leatherbacks has dropped by more than 95%.

Leatherbacks are high-profile victims of a phenomenon known as bycatching—in other words, the wrong species ending up in the net or on the hook. Bycatching threatens species other than turtles. In the north-west Atlantic, for example, the scalloped hammerhead shark has declined by 89% since 1986. It is also wasteful. Daniel Pauly, a fisheries scientist at the University of British Columbia, told the AAAS meeting that he estimates the global total of discarded fish to be between 18m and 40m tonnes a year. The upper bound of this estimate of what gets thrown back is equivalent to almost half the amount of fish that is actually landed.

Some of that bycatch is caused by regulations governing what individual boats may land. A codfish caught by a boat with a cod quota may be landed legally. A boat without a quota has to throw it back, even though it will probably die anyway. But even economically useless species taken as bycatch are being removed from the food chain, to the ultimate detriment of fisheries.

Whether the quota regulations could be changed in ways that would help, rather than hinder, the objective of preserving stocks is dubious. Legitimising the landing of accidental catches of valuable species would probably just lead to more "accidents". But the true effect of bycatching certainly needs to be built into models of marine ecology.

For the leatherbacks, though, there may be two possibilities. The reptiles are mostly the victims of long-line fishing for prey such as swordfish and tuna. (Ironically, environmentalists pushed this method on tuna fishermen, to stop the bycatching of dolphins in nets.) Lines as long as 40km, bearing baited and buoyed hooks at regular intervals, are reeled out across the ocean. Occasionally, a turtle snaps at the bait. Larry Crowder, of Duke University Marine Laboratory, in North Carolina, who has been studying the problem, is trying to design a hook that will catch fish but not turtles. Even if that works, though, it will take time to introduce. So, if people are really concerned about turtle bycatch, he suggests that they boycott swordfish. It worked for dolphins. The question is, are turtles sufficiently charismatic?

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Photonic-crystal fibres

An array of good things

Feb 20th 2003 | DENVER
From The Economist print edition

Intense light trapped in a tiny fibre should have a bevy of uses

ONE of the more notorious legacies of the telecoms and technology bubble of the 1990s was the glut of optical-fibre cable, laid across America to transmit data in the form of light, but which remains persistently dark. It will be an even sadder story if it all has to be replaced in a few years. But if the promise of a technique being developed by Phillip Russell and his colleagues at the University of Bath, in England, is realised, that may yet happen.

Dr Russell discussed the latest developments of photonic crystal fibres (PCFs) at the AAAS meeting. Conventional fibre optics rely on a phenomenon called total internal reflection. Light travelling through a glass fibre bounces off the sides, so long as it hits them at a suitably oblique angle. This works quite well. However, because even the clearest glass is relatively dense, light passing through it has to be amplified every 80km or so. This process is costly and difficult, especially when amplifying stations on the seabed break down. According to Dr Russell, PCFs promise to do much better than this, allowing signals to travel ten times farther without amplification. Their peculiar properties suggest they will have a variety of other applications as well, from compact X-ray sources to the manipulation of single atoms.

The principle that PCFs are based on is the same as that which gives peacocks' feathers their colour. Because the strands of a feather are so close to each other, certain wavelengths of light (which correspond to colours) are strongly reflected, while others are absorbed. A PCF consists of a bunch of narrow fibres made of silica and arranged in a lattice that, in cross section, resembles a honeycomb. The lattice is so fine that light propagation is blocked in every direction—except down the length of the fibre. And it is not just any sort of light that can travel down it. If the fibre is properly constructed, only the so-called fundamental mode will be transmitted. The fundamental mode lacks complicated harmonics (like a pure electronic note in music, bereft of the beauty and complications caused by overtones). This is because the harmonics' structure is smaller than that of the fundamental mode, so that they “leak” through holes in the lattice.

The existence of this effect does not depend on what material the core—the central fibre in the honeycomb lattice—is made of. So, Dr Russell says, this core can be any transparent material. The two simplest candidates, which have been studied in the most depth, are silica (like the rest of the fibre) and air, which will fill any hole left in the lattice. Although doping the core with impurities holds promise for niche applications, having a hollow core is more exciting. Because the light travels through air, not glass, the attenuation should be far lower than in conventional fibres. Furthermore, in PCFs, light of different colours travels at precisely the same speed, eliminating the “chromatic dispersion” that plagues conventional fibres by spreading out a pulse of light (this is easier to do because only the fundamental mode is present).

There is a catch: hollow-core PCFs are devilishly difficult to make. An error of even 1% will result in a fibre that does not transmit light at all. Dr Russell's fabrication method is perhaps the most beguiling aspect of PCFs. His team stumbled on a technique used by the ancient Egyptians to create fine mosaic glass. Small capillaries of silica are stacked into a lattice (in some cases leaving a hole for the hollow-core). The bundle is then run through a furnace at 2,000°C and stretched, like soft putty, until it is sufficiently thin. This process collapses the size of the capillaries by a factor of as much as 50,000, with the resulting holes typically being about 10 millionths of a metre across.

Since the diameter of the pathway that the light travels through is so small, Dr Russell can achieve very high intensities of light. Such high intensities cause a variety of bizarre quantum-mechanical effects. These include the generation of X-rays, of light that can be used as “optical tweezers” to move single molecules around, and of so-called supercontinuum pulses that are bright right across the

electromagnetic spectrum, rather than being confined to a small portion of it. Those pulses could be useful for rapid spectroscopic analyses of unknown substances—such as material that might be associated with chemical or biological weapons. Tests that once took hours might be done in seconds. And you wouldn't even need to dig up the road.

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Adaptive optics

In the twinkling of an eye

Feb 20th 2003 | DENVER
From The Economist print edition

A way for scientists to get better pictures of the retina

TWINKLING stars may be pretty, but astronomers have never loved them. The twinkling, caused by turbulence in the earth's atmosphere, distorts the images and makes it harder to get any useful information. That is why astronomers now use “adaptive optics” to minimise the effects of atmospheric distortion. But adaptive optics may have other applications. Two groups of researchers were at the AAAS meeting to discuss its use in the study of the human eyeball.

Adaptive optics employs mirrors that can deform quickly in tiny ways, in response to commands from a device known as a wavefront sensor. Small, rapidly changing imperfections on the surface of the eye (much smaller than those that can be fixed by a pair of spectacles) vary the distance that light leaving the eye has to travel. The wavefront sensor detects precisely when different bits of light are arriving, and commands the mirror to move slightly closer to tardy bits of light and slightly farther from the over-eager ones.

This is as tricky as it sounds. The computation involved must be done fast, since the mirror has to respond much more quickly than the blink of an eye. But groups from the University of Rochester, New York, and from the University of Houston, have built systems that can take pictures of the eye many times a second, at a resolution about five times better than is otherwise possible.

The Rochester device, which uses a mirror with 97 actuators (which are like tiny pistons) pushing and pulling it from behind, has been tried out in two different types of experiments. The first is to photograph the retina so precisely that individual light-detecting cells can be distinguished. As Jason Porter, one of the researchers at Rochester, told the meeting, this should aid not only a fundamental understanding of how the eye works, but also the diagnosis of diseases.

The second type of experiment uses the adaptive-optics system to test vision, by getting the subject to look at an optician's chart reflected in it. The distortions of the mirror are used to improve the subject's perception of the chart. This is not a practical way to give people super-vision, of course. But it could help to determine how best to carry out corrective surgery.

The Houston group employs a different technique. Rather than using a bright flood of light, as the Rochester researchers do, Austin Roorda and his colleagues employ a laser to scan rapidly across the eye. This is less sensitive to imperfections in the optics, and it allows them to examine the retina at a specific depth—looking at, say, the nerve fibres rather than the blood capillaries. Dr Roorda points out that, since adaptive optics works just as well with incoming as with outgoing light, the techniques being developed in his laboratory could be used to do extremely precise laser surgery. So astronomers will not be the only ones to see clearly.

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About sponsorship

American politics

The limits of spin

Feb 20th 2003
From The Economist print edition

AP

The man who pulls the strings? Or one more voice for George Bush to listen to?

POLITICAL consultants are familiar figures in America, and not just on “The West Wing”. Bill Clinton had the Raging Cajun, James Carville. George Bush senior employed another southern hell-raiser, the late Lee Atwater. Yet few, if any, have been as close to a president in recent times as Karl Rove. He was at George Bush's side from the first, plotting his campaigns, buffing his image, supervising policy tutorials, sifting opinion polls—always positioning his master for the next great battle.

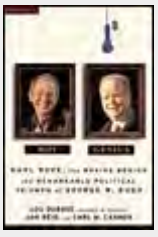
Between elections, Atwater and Mr Carville retreated to the shadows; Mr Rove has an office in the White House. The Republican National Committee is a Rove fief. His fingerprints are often found on public policy—most muckily on steel tariffs. No wonder Mr Bush has two names for him: “boy genius” and “turd blossom”.

The two men could hardly be more different. Mr Bush grew up as an apolitical son in an elective dynasty. Mr Rove was born a political junkie. Mr Bush was the typical frat-boy, always the centre of the crowd. Mr Rove was a natural nerd, complete with spectacles and pocket protector. Mr Bush, the C-student, glided into Yale and Harvard. Mr Rove, the man who arrived in Washington with 148 cases of books, dropped out of the University of Utah after his mother committed suicide.

Although Mr Bush once dabbled in business, Mr Rove was drenched in politics from the start. He rose quickly to the top of the College Republicans in the early 1970s, when many of America's universities were engulfed in protest against the Vietnam war, hooked up next with Atwater and caught the eye of the Republican National Committee. Before long George Bush senior, who had left Washington for Texas, hired Mr Rove for his failed primary run against Ronald Reagan in 1980.

Texas was the making of the young autodidact. Change was blowing strongly through the once Democratic state when he arrived. The national Democratic

Boy Genius: Karl Rove, the Brains Behind the Remarkable Political Triumph of George W. Bush
By Lou Dubose, Jan Reid and Carl M. Cannon



PublicAffairs; 253 pages; $15

Buy it at
Amazon.com
Amazon.co.uk

Bush's Brain: How Karl Rove Made George W. Bush Presidential
By James C. Moore and Wayne Slater

Party's leftward lurch had alienated southern Democrats; a booming Texan economy was attracting droves of conservative northerners. But party shift was not inevitable, and Mr Rove did as much as anyone to consolidate Texas Republicanism, turning it from a suburban insurgency fighting for equality into the state's dominant party. Republicans hold the governorship, both houses of the legislature and the main state-wide offices. To this end, Mr Rove built up a peerless list of party donors, working for all the leading Republicans in the state—including its two present senators, John Cornyn and Kay Bailey Hutchison, its governor, Rick Perry, as well as both the Bushes.

John Wiley; 416 pages; $27.95

Buy it at
Amazon.com
Amazon.co.uk

Now Mr Rove has attracted not one but two biographies. Both are well timed, particularly after the Republicans' remarkable trend-bucking performance in the mid-term elections last November. They are full of interesting material, particularly on Mr Rove's years in Texas. But both books suffer from a pair of failings which blunt their impact and make them in the end more irritating than illuminating.

The first failing is hypersensitivity to scandal. The journalists who produced these books are bloodhounds in pursuit of a scent. They are forever digging up stories that will seem rather bland to those with less sensitive noses. As a College Republican, Mr Rove apparently told his charges to search an opponent's rubbish. Hardly Watergate. Back in Texas, he once saved up a damning fact about one of his opponents—that she had lied about her academic record—and used it at the most damaging time. Oh, my dear.

The second and more serious problem is that neither author can resist inflating their subject's influence. It is not enough that Mr Rove is a successful consultant; instead, he is the “co-president”, a scheming genius who took a witless dauphin and scripted every stage of his rise to power.

But who is the monkey and who is the organ-grinder? Mr Rove is more or less excluded from foreign policy, the issue which will surely define Mr Bush's presidency. In foreign even more than domestic policy Mr Bush has shown an impressive ability to listen to advice, play hawks against doves, and push through his agenda with relentless determination. The real story is not Mr Rove's ability to pull the strings but Mr Bush's ability to pick and manage talented underlings, including supposed puppeteers like Mr Rove.

Boy Genius: Karl Rove, the Brains Behind the Remarkable Political Triumph of George W. Bush
By Lou Dubose, Jan Reid and Carl M. Cannon.
PublicAffairs; 253 pages; $15

Bush's Brain: How Karl Rove Made George W. Bush Presidential.
By James C. Moore and Wayne Slater.
John Wiley; 416 pages; $27.95
and £19.50

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The birth of modern science

Give a dog a bad name

Feb 20th 2003
From The Economist print edition

AS WITH events, so with ideas: the thread of historical development is in reality never broken, but following its course is often easier for us if we can spot (or invent) points where corners are turned, jumps made. David Freedberg, a professor of art history at Columbia University in New York and director of its Italian institute, invites us to focus on one such episode, centred in Italy during the first three decades of the 17th century and involving the handful of scholars who formed themselves into the Academy of the Linceans—the first modern scientific academy. Their institutional title carried twin allusions to Lyncaeus, the most keen-eyed of the Argonauts, and to the lynx, credited with the most acute vision in the animal kingdom.

This is very much Freedberg territory. He is well known in the art-historical world for a widely discussed earlier book, “The Power of Images” (1989), which urged the profession to look harder at how pictures affect us emotionally and how that responsiveness shapes the uses we put them to—in law, politics and religion, for example. A historical essay on vision and science feels a natural continuation.

The Eye of the Lynx: Galileo, His Friends, and the Beginnings of Modern Natural History
By David Freedberg

University of Chicago Press; 528 pages; $50

Buy it at
Amazon.com
Amazon.co.uk

The evidence of their own eyes formed the principal currency of the Linceans' researches and they rejected all canonical wisdom that ran counter to what they could see and record. The first of these credos placed them in the vanguard of the empirical approach to scientific method (Francis Bacon was formulating his own philosophy, which enshrined similar principles, at this same moment in England). Their challenge to received authority led them into hazardous territory guarded by conservatives in the Catholic church.

That conflict is epitomised in the researches of Galileo, most famous of the Linceans. When Galileo trained his new-fangled telescope on the heavens, the edifice of Aristotelian cosmology, embraced by the church as a matter of faith, began to crumble: the incorruptible crystal spheres held to enclose the universe with the earth at its centre gave way to a model that was both dynamic and heliocentric. The support of the Lincean academy was crucial to Galileo during his most productive years, when he benefited too from the indulgence of Pope Urban VIII and his nephew Cardinal Francesco Barberini—himself elected a Lincean. The eventual withdrawal of support from the Barberini clan proved catastrophic to Galileo and it was his erstwhile protector, Urban VIII, who sent him to the Inquisition.

The moving spirit behind the Lincean academy, however, was not Galileo but Federico Cesi, an enlightened nobleman who provided not only intellectual impetus but also financial support, above all in the field of natural history. His ambitions, never modest, centred on a scheme to reduce description of the entire natural world to tabular form. Before arriving at this extreme reductionism, Cesi and his circle had originally launched quite a different exercise—a project to record nature's variety in pictures.

There are many remarkable features to the thousands of illustrations the Linceans amassed (partly surviving in the Royal Collection at Windsor), including the earliest records of numerous plant species and the first graphic representations of observations by microscope—as revolutionary a development as Galileo's use of the telescope. Indeed, thanks partly to the newly invented microscope, the Linceans abandoned their attempt at an encyclopedic pictorial record when they saw that nature's complexities would have to be explained by appeal to inner structures, not by cataloguing arbitrary variations in external form and colour.

The evidence of the testicles

Other hallowed systems of belief were to fall before this new insistence on objective classification. Physiognomy and phytognomy, for example, by which plants and animals had assigned to them particular powers or properties on the basis of resemblance to various parts of the human body, were soon revealed in all their inadequacy. New scrutiny was turned too on whole swathes of nomenclature that enshrined such pretended resemblances—encapsulated most memorably in the plant graced by the name of *Testicoli di cane*—the dog's bollocks.

Wholehearted approval was surely richly earned by the Linceans themselves, and Mr Freedberg is persuasive in his advocacy of their pioneering work. He never goes so far as to become their eulogist, however, and sympathetically acknowledges their shortcomings as well as their triumphs. Often they found themselves simply overwhelmed by the scale of the task they had set themselves. Demolishing one world order was work enough, but replacing it by another, based on numbers, proved hugely more demanding.

Mr Freedberg has also tackled an enormous task in digesting the contents and implications of the publications, drawings, notebooks and correspondence of the Linceans, much of it in Latin or Italian, some in their private cipher. The University of Chicago Press has produced an exceptionally beautiful volume from his authoritative and elegantly written text; it is richly illustrated with the Linceans' drawings, which, however, give only a glimpse of the riches to be found in the Royal Collection's definitive *catalogue raisonné* (the source of many of Mr Freedberg's illustrations), currently in the process of publication in 36 volumes. This series, entitled “The Paper Museum of Cassiano dal Pozzo” and representing the kind of systematic treatment the Linceans themselves failed so signally to achieve nearly four centuries ago, bears the name of the last of their number, responsible for the preservation of so much of their legacy for posterity. Mr Freedberg in turn has honoured their memory with his new work. “The Eye of the Lynx” is a remarkable, and most desirable book.

The Eye of the Lynx: Galileo, His Friends, and the Beginnings of Modern NaturalHistory.
By David Freedberg.
University of Chicago Press; 528 pages; $50

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About sponsorship

Independent films

Exactly what is it about “no” you don't understand?

Feb 20th 2003
From The Economist print edition

The no-noes of a cinema doctrine continue to produce remarkably watchable films

IT'S probably not what you expected, but three new films—two Danish, one American—show beyond doubt that Dogma 95, the austere production manifesto that emanated from Copenhagen, is still inspiring fresh, arresting work eight years on. “Open Hearts”, the latest film to be made under Dogma 95's vow of chastity—no artificial lighting, no make-up, no added music, no genre stories—carries its credentials well. Directed by Susanne Bier (openly credited though the rules disallow it), the film is a fine example of where the manifesto works, and where it is best to junk it.

The plot is somewhat surreal (Mike Leigh meets Pedro Almodóvar). Cecilie and Niels fall in love after Niels's wife runs over Cecilie's fiancé with her car. But the closeness that the Dogma style allows between the actors and the audience maintains the emotion of a moving and poignant love story. The actors, freed from the dictates of lighting, circle and confront one another with the electricity of a documentary. Mads Mikkelsen is outstanding as the confused, reticent Niels.

Like Mark Twain with the truth, Ms Bier sticks to the rules but stretches them a little. We hear Cecilie's Walkman as clearly as if we wore the headphones ourselves, while a greying of the film's tone and a whirring sound reminiscent of Super-8 (though the film was shot in digital) reveal the character's internal thoughts: for example, Cecilie imagining her fiancé, in reality paralysed from the neck down, reaching out to touch her face. The result is a string of moments forming a sharply drawn narrative arc that remains true to the spirit of Dogma, even as it indicates where to cross some of the manifesto's boundaries.

It was this spirit, not the letter, that was the inspiration for the founding of InDigEnt, an American production company dedicated to financing independent digital films. Like Dogma 95, cast and crew agree to certain limitations. In this case, very low budgets and short production schedules. At the 2002 Sundance film festival, InDigEnt won both the grand jury and directing awards, for “Personal Velocity” and “Tadpole”. At this year's Sundance festival in January, they returned with Peter Hedges's first feature, “Pieces of April”.

Katie Holmes, in perhaps her best performance yet, plays April, prodigal daughter to Joy (a brilliant Patricia Clarkson), who is bitter and dying of cancer. April has been persuaded by her boyfriend to cook Thanksgiving dinner for the family, but she can't cook and her oven is broken. While she races up and down the stairs of her rundown Lower East Side apartment block trying to find a friendly neighbour to help, Joy and the family drive hesitantly towards the city. The script is watertight and the camera is light

but insistent. Just as with Dogma films, the actors seem unaffected by the presence of the camera, as if they were performing for themselves rather than the director. Each moment resonates with the unpredictability of reality.

If anyone should understand Dogma 95 it is Thomas Vinterberg, a director who co-founded the movement together with Lars von Trier. Only 26 at the time, Mr Vinterberg had perhaps the least to gain from the experiment, yet his and Dogma 95's first film, “Festen” (The Celebration), won popular and critical acclaim as well as a special jury prize at Cannes in 1998. Five years later, Mr Vinterberg brings us his response to this success in “It's All About Love”. Elena (Claire Danes), an internationally famous ice skater, and husband John (Joaquin Phoenix) try to rediscover their passion for each other while evading Machiavellian attempts on their lives amid a world that feels out of balance.

On the surface the film is the antithesis of Dogma 95. It is shot almost entirely on set, has a musical score, murders, butcher knives, special effects, plenty of make-up and costumes, and is a romance thriller set in 2021. Mr Vinterberg has embraced what Dogma 95 rejected: the illusion of sensation. But, with the help of Ben van Os's flawless sets and Anthony Dod Mantle's rich widescreen lenses, he has created a perfect saturation job, and in so doing kept to the essence of Dogma. Plot has become a vehicle for the illusion of each moment—climatic irregularities allow Elena and John to find their elusive love in a sudden July snowstorm. Yet these moments never seem forced. Traditional dramatic points pass by as softly and smoothly as Ms Danes's Hitchcock-era wardrobe, while underneath everything, though never fully revealed, is the menacing hum of uncertainty and anticipation.

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About sponsorship

Hollywood moguls

What made Sam run?

Feb 20th 2003
From The Economist print edition

AS USUAL, Billy Wilder has the slyest line. “Sam Spiegel! That's quite a subject.” Spiegel, who died in 1985, was the outstanding independent producer of the 1950s and the early 1960s—the muscle behind “The African Queen” and “On the Waterfront”, “The Bridge on the River Kwai” and “Lawrence of Arabia”. Yet to many he was a riddle; and most likely he preferred it that way. During a long and improbable life Spiegel sloughed off more skins than a bed of snakes, and a biographer's first task is to keep their footing.

Sam Spiegel
By Natasha Fraser-Cavassoni

Simon & Schuster; 480 pages; $30.
Little, Brown; £22.50

Buy it at
Amazon.com
Amazon.co.uk

Natasha Fraser-Cavassoni is not the first to enter this territory, but she stays alert. Her account is probably the fullest yet, though early facts remain sparse. Spiegel was born in or about 1901 in Western Galicia, now south-east Poland; he was raised there but claimed to have grown up in Vienna. A quick-witted boy, he had a good schooling and at 18 was a leading light in a Zionist youth movement, settling early in Palestine. Ever restless, seven years later he vanished to the United States, leaving a wife, a daughter and a string of kited cheques. In America he posed as a diplomat, receiving a nine-month jail term for his deceit. Back in Europe, he escaped first from Germany, then from Austria, only to find himself locked up again in London and deported from France. Undaunted, he crossed the Atlantic once more and sneaked back into the United States, perhaps by wading the Rio Grande, en route to Tinseltown.

In Europe, along the way, he had produced three films. Few in Hollywood knew of them. So he threw parties instead. Lack of scruple was overlain by charm, manners and a seemingly irresistible gift for persuasion. Soon his New Year's Eve bash was the place to be seen. If you wanted somewhere to gamble or a “high-class mush pit”, Spiegel's was the right address; Marilyn Monroe was said to be one of the house girls. People wondered how he paid for it all; mostly he didn't.

Honesty came no more easily to Spiegel than financial regularity. To get his way, he would fake heart attacks. “Telling the truth unnerved him”, according to an acquaintance. What better playground than the town Brecht called a marketplace of lies? After two bold but moderately successful pictures—one with Orson Welles and another by Julien Duvivier with what seemed like every star and scriptwriter then working—Spiegel teamed up with John Huston, first on “We Were Strangers” (1949), then on an indisputable hit, “The African Queen” (1951). Huston, the directorial wunderkind, owed Spiegel money, we are told, and Spiegel garnered his salary in order to pay his own income-tax bill.

Gore Vidal thought Spiegel “spontaneously dishonest on every level”. Yet for all the double-dealing, his creative ambitions were real. He had an instinct for the storyline and for a new kind of spectacle, a knack for casting and a willingness to tackle subjects others would not touch. Oscars rained on “On the Waterfront” (1954), “The Bridge on the River Kwai” (1957) and “Lawrence of Arabia” (1962). After these successes, his career dived. Megalomania? Boredom? Falling behind the times? Perhaps all three. More and more energy went into parties on his yacht and into feeding his astonishing sexual appetite with girls who never got older.

Ms Fraser-Cavassoni gives free rein to the gossip. Her book is thoroughly researched and entertaining, though lightly edited for grammar. For all the good stories, this reader was left wondering what made Spiegel run. His biographer is probably not to blame: no one, it seems, knew.

Sam Spiegel.
By Natasha Fraser-Cavassoni.

Simon & Schuster; 480 pages; $30.
Little, Brown, £22.50

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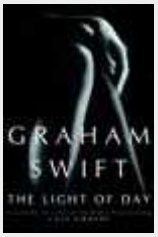
New fiction

Short takes

Feb 20th 2003
From The Economist print edition

A WRITER who likes to take bold, and ultimately rewarding, risks with style and structure, Graham Swift stages “The Light of Day” in a single day, when most of the action is past. The narrator, George Webb, is a disgraced policeman now private eye. He carries out a regular mission to lay roses on the grave of Bob, an unfaithful husband murdered by his wife, Sarah, who was, and still is, George's client. He later visits Sarah in prison. In love (particularly, and rather quirkily, with her knees), he looks to her release in eight or nine years. In the meantime, he waits for Rita, an ex-lover and now his employee in the detective agency, to leave him, and meditates on his own failed marriage and his barely rescued fatherhood.

The Light of Day
By Graham Swift



Knopf; 304 pages; $24.
Hamish Hamilton; £16.99

Buy it at
Amazon.com
Amazon.co.uk

The style is unremittingly jerky. For most of this book, Mr Swift has chosen to write in short, questioning sentences, sometimes two or three words only, packing his explanations into brackets. At first, all those full stops can be irritating but the rocking-horse style becomes lulling, persuading you to read on, to find out what happened and why. And his choice of adjectives is compelling: “The sizzly civilised sound of tyres on gravel”; “the usual clattery messy coffee place”; “the mercilessness of a multi-storey car park”; “a quick-eyed, quick-lipped woman”.

Almost reluctantly, this reader was won over. There are no surprises, no revelations; just the slow unwinding of a domestic tragedy. Kristina, the murdered man's mistress (whom he lets go), is the child of a darker tragedy, a Croatian whose family was killed in the Yugoslav wars. Against the gloom, is the warmth and fun of food, its comforting smells.

George and Sarah were drawn beyond their professional relationship in the fine-food section of a supermarket; George won his estranged daughter back with his gentle, celebratory cooking; Sarah looked to welcome home her straying husband with coq au vin. Instead, she killed him with a knife, green from chopped parsley. Why? Since the elliptical story, its people and their motives are all seen strictly through George's eyes and imagination, the reader is left half-understanding, but pondering in a satisfying sort of way.

The Light of Day.
By Graham Swift.
Knopf; 304 pages; $24.
Hamish Hamilton; £16.99

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About sponsorship

Walt Rostow

Feb 20th 2003
From The Economist print edition

Walt Rostow, an adviser in the Vietnam war, died on February 13th, aged 86

AP

EARLY one morning in 1958 Walt Rostow arrived at John Kennedy's Washington home in Georgetown. He had been invited for breakfast. In Kennedy's cultivation of people who might be useful to him in his campaign to become president, an invitation to breakfast was no more than a courteous overture. It did not carry the weight of a lunch or dinner, but was possibly more important than a drink at a bar or an invitation to a “political tea”, a ceremony usually hosted by Kennedy's wife Jacqueline. In the event the two men got on well. Both were in the early 40s, close to middle-age by ordinary reckoning, but young for anyone with ambitions in high politics. Mr Rostow thought up a Kennedy campaign slogan, “Let's get this country moving again”. In 1961 Kennedy became the youngest president in American history and Mr Rostow joined his team of advisers.

In 1960 he had published “The Stages of Economic Growth: A Non-Communist Manifesto”. He argued that if poor countries were provided with enough capital to achieve “take-off”, or rapid economic growth, they would embrace capitalism and democracy, rather than communism. In fact the United States was becoming disenchanted with its aid programmes. Much of the money was being misused by poor countries or going into the pockets of their leaders, rather than being a useful tool to contain communism. But Mr Rostow's ideas matched the mood of the Kennedy administration. It fitted with liberal notions of ending poverty at home and devising a welfareish state. Kennedy declared the 1960s the “decade of development”, and Mr Rostow was allowed to try out his ideas.

He became particularly concerned with South-East Asia. South Vietnam was getting American aid, and prospering. But it was being undermined by guerrillas infiltrating from communist North Vietnam. If the South fell, Mr Rostow feared that a series of countries would topple like dominoes into the communist grasp: Cambodia, Thailand, Malaysia and Singapore. His remedy was that the United States should use force to rid South Vietnam of guerrillas to allow the country to continue to develop successfully. It was this policy, seemingly carefully thought-out, that dragged America deeper and deeper into what came to be called the Vietnam war.

War and peace

His full name was Walt Whitman Rostow. He showed no flair for poetry, but in other respects he more than fulfilled the hopes of his parents, Jewish immigrants from Russia, that he would grow up to be a successful American. He graduated from Yale at the age of 19, and spent three years as a Rhodes scholar at Oxford. In the second world war he was attached to the Office of Strategic Services, an intelligence unit, picking targets in Germany for American bombers to attack, and rose to the rank of major.

After the war he spent some time in government advising on Germany and working on the Marshall plan, America's aid programme for Europe. He taught economic history at the Massachusetts Institute of Technology and other colleges, and worked on his book on economic growth, the subject that brought him to the notice of Kennedy, and which remains the best known of his 30 works.

Mr Rostow's advice to “gear up” the Vietnam operation was often contested in the Kennedy camp. Some close to the president said America was getting too involved. Kennedy's own published view was that he was committed to supporting South Vietnam at least until the next American election in 1964. At the

time of his murder in 1963 the United States had 16,000 military “advisers” in Vietnam, training the southerners in anti-guerrilla warfare but, at least officially, no Americans were engaged in combat.

Kennedy's successor, Lyndon Johnson, took a more robust view of the Vietnam conflict. He promoted Mr Rostow to be national security adviser, one of the most senior jobs in the administration and held today by Condoleezza Rice. Under what became known as the “Rostow thesis” American combat troops were sent in increasing numbers to Vietnam and the North was bombed, at first on limited targets such as fuel depots and later more generally. He gained a reputation as a hawk or, because of his polite manner, that he was “a sheep in wolf's clothing”, as one commentator put it. He would, said his colleagues, be ever optimistic and claim that the Americans and their Vietnamese allies were winning, producing estimated large “body counts” of dead northerners. But others were counting the American dead, more than 50,000 out of the 550,000 who served in Vietnam. The United States began to withdraw when Richard Nixon became president in 1969 and finally quit in 1973. The South surrendered to the North in 1975.

By then Mr Rostow had returned to academe, teaching and writing books. He was often interviewed about the war. He agreed that it was a bitter experience for the United States, but he never shifted from his view that it achieved its aim: that it delayed the communist advance long enough for South-East Asia to have time to grow economically. His role in the Vietnam conflict, he said, was as a development economist.

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Overview

Feb 20th 2003
From The Economist print edition

America's industrial production rose in January by 0.7%. But other data suggest that consumers are stuttering as an engine of economic growth. The University of Michigan's consumer-confidence index fell from 82.4 in January to a preliminary reading of 79.2 in February, the lowest since 1993. Retail sales fell by 0.9% in January.

Housing remains one of America's few sectors with strong growth. In January, housing starts (at an annual rate) rose to a near-17-year high.

Euro-area manufacturing is sliding. In December, industrial production fell by 1.5%. Compared with a year ago, industrial production was down by 0.5%.

Germany's ZEW economic-expectations survey rose from 14.0 in January to 15.0 in February; forecasters had expected a drop. But German factory orders for December fell by 4.4%, a downward revision from the earlier 4.1% decline. In **Italy**, industrial output fell by 0.6% in December; year-on-year it rose by 2.1%, compared with a 4.2% drop in 2001. In **Austria**, consumer-price inflation was unchanged at 1.8% in January. **German** workers received a 2.7% pay rise in the year to December. And unemployment in **the Netherlands** was 4.3% in the three months to January, up from 3.4% a year ago.

Sweden's economy is showing signs of weakness. Industrial production fell by 2.0% in the year to December. Unemployment rose to 5.1% in January, from 4.1% in December. Meanwhile, sluggish growth is taking its toll on **Switzerland's** consumers: retail sales fell by 2.8% in the year to December.

Japan's economy avoided another recession. GDP grew by 0.5% in the three months to December, the fourth quarter in a row of positive growth. On an annualised basis, GDP grew by 2.0% in the quarter. The news caused the Nikkei to rise and the yen to strengthen against the dollar. However, industrial production in December fell by a revised 0.4%, worse than expected.

Consumer-price inflation in **Britain** continued to exceed the government's 2.5% target in January. RPIX, an inflation measure that excludes mortgage-interest payments, was unchanged at 2.7% in the year to January. The Bank of England said that RPIX would get even closer to 3.0% in future months, before falling back again.

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Output, demand and jobs

Feb 20th 2003
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr*	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 3.5	+ 3.7 Q3	+ 3.7	+ 3.2	+ 1.6 Q3	+ 5.4 Q4	6.1 Jan	7.0
Austria	+ 0.3	+ 1.2 Q3	+ 0.8	+ 1.3	+ 1.7 Nov	+ 0.6 Nov	4.2 Dec	3.9
Belgium	+ 1.8	+ 0.9 Q3	+ 0.7	+ 1.4	− 0.8 Dec	− 0.9 Nov	11.9 Jan†	10.9
Britain	+ 1.3	+ 2.2 Q4	+ 1.7	+ 2.3	− 1.4 Dec	+ 4.2 Jan	5.1 Dec††	5.2
Canada	+ 3.1	+ 4.0 Q3	+ 3.3	+ 3.1	+ 4.9 Nov	+ 2.4 Nov	7.4 Jan	7.9
Denmark	− 2.6	+ 1.1 Q3	+ 1.6	+ 1.7	− 1.7 Dec	+ 7.5 Oct	5.4 Dec	5.1
France	+ 0.9	+ 1.0 Q3	+ 1.0	+ 1.5	− 0.1 Dec	− 1.9 Dec	9.1 Dec	8.8
Germany	+ 1.1	+ 0.4 Q3	+ 0.2	+ 0.6	− 0.5 Dec	− 3.2 Dec	10.3 Jan§	9.6
Italy	+ 1.1	+ 0.5 Q3	+ 0.4	+ 1.2	+ 2.1 Dec	+ 1.9 Nov‡	8.9 Oct	9.3
Japan	+ 2.0	+ 2.6 Q4	− 0.3	+ 0.2	+ 6.4 Dec	− 3.0 Dec	5.5 Dec	5.5
Netherlands	+ 0.4	+ 0.3 Q4	+ 0.2	+ 0.9	− 6.8 Dec	− 2.5 Dec	4.3 Jan**	3.4
Spain	+ 3.2	+ 1.8 Q3	+ 2.0	+ 2.3	+ 2.5 Dec	+ 4.8 Nov‡	12.0 Dec	10.7
Sweden	+ 1.6	+ 2.0 Q3	+ 1.8	+ 2.0	− 2.0 Dec	+ 5.9 Dec	5.1 Jan†	4.4
Switzerland	+ 1.3	+ 0.6 Q3	nil	+ 0.9	− 3.5 Q3	− 2.8 Dec	3.8 Jan†	2.6
United States	+ 0.7	+ 2.8 Q4	+ 2.4	+ 2.5	+ 2.0 Jan	+ 4.9 Dec	5.7 Jan	5.6
Euro area	+ 1.2	+ 0.9 Q3	+ 0.7	+ 1.3	− 0.5 Dec	− 0.4 Nov	8.5 Dec	8.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.9	+ 2.3 Q3	na	na	+ 7.9 Dec	+ 2.0 Nov	9.5 Jan†	9.9
Greece	na	+ 3.6 Q3	na	na	+ 5.0 Dec	na	na	na
Iceland	na	+ 3.62001	na	na	+12.2 2001	na	3.8 Jan	2.4
Ireland	na	+ 6.9 Q3	na	na	− 6.6 Dec	− 0.4 Dec	4.5 Jan	4.2
Luxembourg	na	+ 1.02001	na	na	+ 1.9 Nov	− 2.3 Sep	3.4 Dec†	2.7
New Zealand	+ 5.0	+ 5.0 Q3	na	na	+ 5.1 Q3	+ 8.1 Q3	4.9 Q4	5.4
Norway	− 0.9	+ 1.0 Q3	na	na	− 4.4 Dec	+ 3.2 Dec	3.7 Q4	3.3
Portugal	na	− 0.5 Q3	na	na	− 1.8 Dec	− 3.5 Dec	5.1 Q3†	4.0

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Oct-Dec; claimant count rate 3.1% in Jan. §EU harmonised rate 8.6% in Jan. **Nov-Jan, new series

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Prices and wages

Feb 20th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 3.0	Q4	+ 3.1	+ 3.0	+ 2.7	+ 1.6	Q4	– 0.7	+ 3.6	Q3	+ 4.0
Austria	+ 1.8	Jan	+ 2.1	+ 1.8	+ 1.6	+ 1.4	Jan	– 0.4	+ 2.2	Dec	+ 2.7
Belgium	+ 1.2	Jan	+ 2.9	+ 1.7	+ 1.3	+ 1.4	Dec	– 2.6	+ 2.2	Q4	+ 3.1
Britain	+ 2.9	Jan	+ 1.3	+ 2.1	+ 2.6	+ 1.6	Jan	– 0.6	+ 3.7	Dec	+ 3.4
Canada	+ 3.9	Dec	+ 0.7	+ 2.2	+ 2.6	+ 2.8	Dec	– 2.4	+ 2.1	Nov	+ 3.1
Denmark	+ 2.6	Jan	+ 2.5	+ 2.4	+ 2.1	+ 1.3	Jan	+ 0.6	+ 3.9	Q3	+ 4.3
France	+ 2.3	Dec	+ 1.4	+ 1.9	+ 1.5	+ 1.7	Dec	– 1.6	+ 3.4	Q3	+ 4.2
Germany	+ 1.1	Jan	+ 2.1	+ 1.3	+ 1.0	+ 1.2	Jan	+ 0.2	+ 2.7	Dec	+ 2.2
Italy	+ 2.8	Jan	+ 2.4	+ 2.6	+ 2.2	+ 1.5	Dec	– 1.3	+ 2.1	Dec	+ 2.8
Japan	– 0.3	Dec	– 1.2	– 0.9	– 0.7	+ 0.3	Nov	– 0.8	– 1.9	Dec	– 1.9
Netherlands	+ 2.5	Jan*	+ 4.0	+ 3.8	+ 2.5	+ 4.0	Dec	– 2.2	+ 3.4	Dec	+ 4.9
Spain	+ 3.7	Jan	+ 3.1	+ 3.5	+ 2.9	+ 2.0	Dec	– 0.8	+ 3.8	Q3	+ 3.6
Sweden	+ 2.8	Jan	+ 2.9	+ 2.4	+ 2.1	– 0.6	Dec	– 0.8	+ 3.9	Nov	+ 3.0
Switzerland	+ 0.8	Jan	+ 0.5	+ 0.7	+ 0.7	– 0.2	Jan	– 1.4	+ 2.5	2001	+ 1.3
United States	+ 2.4	Dec	+ 1.6	+ 1.6	+ 2.1	+ 1.2	Dec	– 1.6	+ 2.7	Jan	+ 3.8
Euro area	+ 2.1	Jan	+ 2.0	+ 2.2	+ 1.7	+ 1.5	Dec	– 1.0	+ 3.3	Q3	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.4	Jan	+ 2.3	na	na	+ 1.4	Dec	– 2.7	+ 3.5	Q3	+ 4.7
Greece	+ 3.1	Jan	+ 4.4	na	na	+ 1.4	Dec	+ 1.5	na		na
Iceland	+ 1.5	Feb	+ 8.9	na	na	+ 2.7	Jan	+11.4	+ 5.4	Dec	+ 9.6
Ireland	+ 4.8	Jan	+ 4.9	na	na	– 0.6	Dec	+ 0.2	+ 6.2	Q3	+ 8.1
Luxembourg	+ 2.3	Jan	+ 2.3	na	na	– 0.2	Nov	– 1.0	+ 3.5	Nov	+ 4.2
New Zealand	+ 2.7	Q4	+ 1.8	na	na	– 1.7	Q3	+ 6.2	+ 2.1	Q4	+ 2.2
Norway	+ 5.0	Jan	+ 1.3	na	na	+11.6	Jan	– 8.2	+ 5.0	Q3	+ 4.8
Portugal	+ 4.0	Dec	+ 3.7	na	na	+ 1.3	Dec	+ 0.6	+ 0.2	Dec*	+ 2.2

*Revised series

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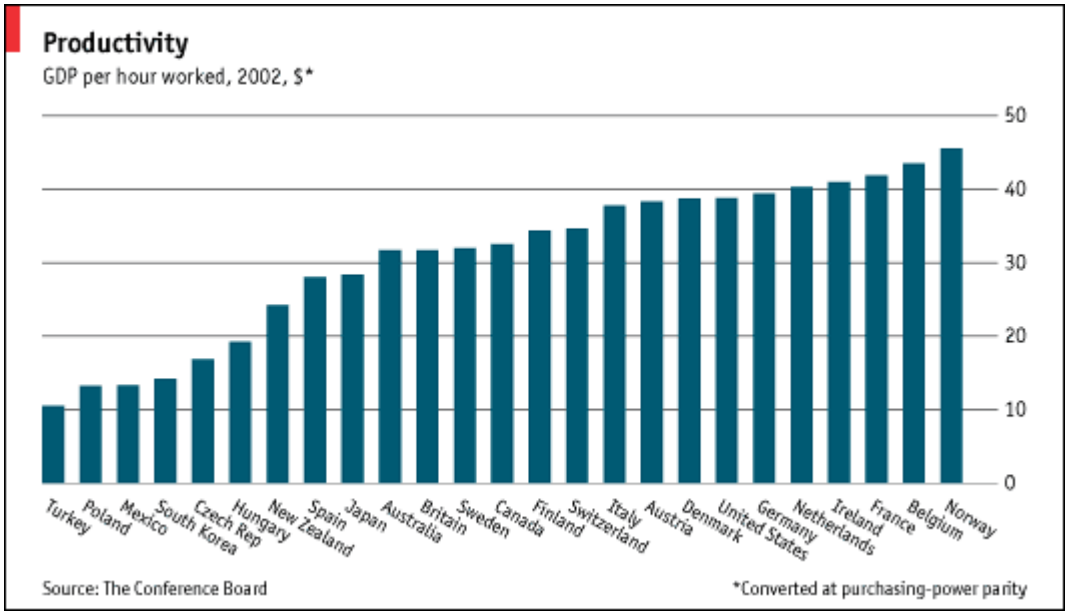
Productivity

Feb 20th 2003
From The Economist print edition



America's workers are more productive than Europe's, and the gap is widening. But several European countries have higher levels of output per man-hour than the United States. America can claim to have higher living standards, as measured by GDP per person, only because more people are employed and they work longer hours. By contrast, France, ranked third in productivity, ranks only 16th in GDP per head.

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Money and interest rates

Feb 20th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Feb 19th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 9.2	+10.6	Dec	4.69	4.30	4.47	5.22	5.92	6.19
Britain	+ 5.5	+ 7.0	Dec	3.63	4.00	3.36	4.15	5.07	5.88
Canada	+ 5.0	+ 5.1	Dec	2.78	2.03	3.48	5.06	5.36	6.87
Denmark	+ 3.8	+ 4.6	Dec	3.11	3.70	2.71	4.13	5.09	6.73
Japan	+23.6	+ 2.0	Jan	0.03	0.05	0.04	0.87	1.52	1.00
Sweden	+ 0.6	+ 2.8	Nov	3.60	3.84	3.58	4.39	5.30	4.03
Switzerland	+10.1	+ 5.6	Dec	0.60	1.68	0.32	2.23	3.86	3.18
United States	+ 2.9	+ 6.2	Jan	1.38	1.82	1.60	3.86	4.93	6.06
Euro area†	+ 9.8	+ 6.8	Dec	2.69	3.35	2.43	3.89	4.88	4.27

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.82%, Japan No.246 0.86%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Feb 20th 2003
From The Economist print edition

1995=100

	Feb 11th	Feb 18th*	% change on one month	% change on one year
Dollar index				
All items	79.8	78.8	+ 2.5	+16.8
Food	82.0	81.4	+ 2.8	+19.4
Industrials				
All	76.7	75.3	+ 2.0	+13.1
Nfa†	79.7	78.8	+ 4.5	+19.4
Metals	74.2	72.3	– 0.1	+ 7.8
Sterling index				
All items	77.8	78.1	+ 3.6	+ 4.8
Euro index				
All items	97.9	97.0	+ 2.4	– 4.5
Yen index				
All items	103.0	99.9	+ 2.9	+ 4.1
Gold				
$ per oz	363.25	344.75	– 3.4	+15.6
West Texas Intermediate				
$ per barrel	35.45	36.84	+ 8.2	+78.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Feb 20th 2003
From The Economist print edition

Market indices

	Feb 19th	2002-03 high	2002-03 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,849.9	3,440.0	2,804.4	– 0.6	–17.2	–15.2	– 1.6
Austria (ATX)	1,158.4	1,357.2	1,003.7	+ 2.0	–33.3	+ 1.6	+22.5
Belgium (Bel 20)	1,802.6	2,899.8	1,744.3	+ 2.1	–51.0	–35.2	–21.8
Britain (FTSE 100)	3,658.3	5,323.8	3,480.8	+ 1.2	–47.2	–29.9	–23.2
Canada (Toronto Composite)	6,559.7	7,958.1	5,695.3	+ 1.7	–42.4	–14.7	–10.0
Denmark (KBX)	156.8	233.4	152.5	+ 2.5	–48.0	–30.2	–15.8
France (SBF 250)	1,914.9	3,081.9	1,794.5	+ 2.7	–56.4	–35.8	–22.5
(CAC 40)	2,859.2	4,688.0	2,656.5	+ 3.2	–58.7	–38.2	–25.4
Germany (DAX)	2,624.7	5,462.6	2,555.3	+ 2.1	–67.5	–49.1	–38.6
Italy (BCI)	1,071.4	1,513.0	974.4	+ 2.3	–50.9	–25.3	– 9.8
Japan (Nikkei 225)	8,678.4	11,979.9	8,303.4	+ 0.2	–77.7	–17.7	– 9.1
(Topix)	853.6	1,139.4	760.1	– 0.4	–70.4	–17.3	– 8.7
Netherlands (AEX)	286.1	531.2	274.8	+ 3.9	–59.2	–43.5	–31.9
Spain (Madrid SE)	631.2	848.1	568.5	+ 3.1	–44.9	–23.4	– 7.6
Sweden (Affarsvarlden Gen)	142.8	236.8	122.7	+ 3.6	–64.3	–38.3	–23.7
Switzerland (Swiss Market)	4,210.9	6,694.1	4,152.2	+ 1.4	–49.9	–34.4	–20.4
United States (DJIA)	8,000.6	10,635.3	7,286.8	+ 3.1	–31.8	–20.2	–20.2
(S&P 500)	845.1	1,172.5	776.8	+ 3.2	–44.7	–26.4	–26.4
(NASDAQ Comp)	1,334.3	2,359.5	1,114.1	+ 4.3	–73.6	–31.6	–31.6
Europe (FTSE Eurotop 300)*	785.3	1,279.7	769.5	+ 1.4	–53.9	–37.7	–24.9
Euro area (FTSE Ebloc 100)*	665.6	1,125.1	639.4	+ 2.8	–57.1	–40.2	–27.8
World (MSCI)†	761.2	1,024.4	703.7	+ 2.5	–47.5	na	–24.2
World bond market (Salomon)‡	536.4	537.9	430.3	+ 0.7	– 0.3	na	+22.0

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 20th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† 1990=100 Feb 19th	year ago	Currency units per $ Feb 19th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	− 5.3	Dec	− 14.3	Q3	− 3.9	− 4.2	76.2	74.7	1.68	1.93	2.69	1.81	1.42	0.1
Austria	+ 0.4	Nov	+ 0.8	Dec	− 0.1	− 0.4	101.3§	100.3	0.93	1.15	1.48	–	0.78	-1.6
Belgium	+ 17.5	Dec	+ 18.0	Nov	+ 5.2	+ 5.1	100.7§	99.0	0.93	1.15	1.48	–	0.78	nil
Britain	− 51.8	Dec	− 20.5	Q3	− 1.6	− 1.8	101.8	107.6	0.63	0.70	–	0.67	0.53	-1.4
Canada	+ 28.9	Nov	+ 12.4	Q3	+ 1.9	+ 1.9	77.7	76.2	1.51	1.59	2.41	1.63	1.27	0.6
Denmark	+ 8.0	Dec	+ 5.0	Dec	+ 2.2	+ 2.0	104.7	101.9	6.92	8.52	11.0	7.43	5.83	2.2
France	+ 9.7	Dec	+ 28.3	Dec	+ 1.7	+ 1.7	103.7§	101.7	0.93	1.15	1.48	–	0.78	-2.7
Germany	+119.3	Dec	+ 50.4	Dec	+ 2.1	+ 1.8	100.8§	98.6	0.93	1.15	1.48	–	0.78	-3.7
Italy	+ 10.5	Nov	− 5.0	Nov	− 0.2	− 0.2	74.0§	72.6	0.93	1.15	1.48	–	0.78	-2.3
Japan	+ 94.1	Dec	+115.0	Dec	+ 2.8	+ 2.8	131.6	127.1	119	134	189	128	–	-7.9
Netherlands	+ 29.0	Dec	+ 9.1	Q4	+ 3.1	+ 2.6	99.9§	98.0	0.93	1.15	1.48	–	0.78	-0.8
Spain	− 38.7	Nov	− 15.3	Nov	− 2.2	− 2.1	75.5§	74.3	0.93	1.15	1.48	–	0.78	nil
Sweden	+ 14.8	Dec	+ 9.9	Dec	+ 3.5	+ 3.2	79.5	75.7	8.48	10.6	13.5	9.11	7.14	1.7
Switzerland	+ 4.8	Dec	+ 29.8	Q3	+10.3	+10.8	116.1	111.4	1.37	1.70	2.18	1.47	1.15	na
United States	−467.0	Nov	−462.2	Q3	− 4.8	− 5.0	108.5	123.9	–	–	1.60	1.07	0.84	-3.1
Euro area	+ 97.7	Dec	+ 54.0	Nov	+ 0.7	+ 0.8	86.3	78.2	0.93	1.15	1.48	–	0.78	-2.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.2	Dec	+ 10.3	Dec	na	na	79.6§	78.5	0.93	1.15	1.48	–	0.78	3.2
Greece	− 21.5	Dec	− 9.0	Dec	na	na	58.3§	57.5	0.93	1.15	1.48	–	0.78	-1.1
Iceland	+ 0.2	Nov	nil	Q3	na	na	92.1**	83.4	79.0	100.8	126	84.9	66.6	0.3
Ireland	+ 35.9	Nov	+ 0.1	Q3	na	na	90.3§	87.4	0.93	1.15	1.48	–	0.78	-0.5
Luxembourg	− 3.0	Nov	+ 2.1	Q3	na	na	100.7§	99.0	0.93	1.15	1.48	–	0.78	1.8
New Zealand	− 0.7	Dec	− 1.7	Q3	na	na	97.1	82.7	1.81	2.38	2.88	1.94	1.52	1.6
Norway	+ 26.8	Jan	+ 26.1	Nov	na	na	105.2	98.4	7.00	8.91	11.2	7.52	5.90	12.4
Portugal	− 12.9	Nov	− 9.8	Nov	na	na	91.1**	90.2	0.93	1.15	1.48	–	0.78	-3.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD estimate. **IMF, October average.

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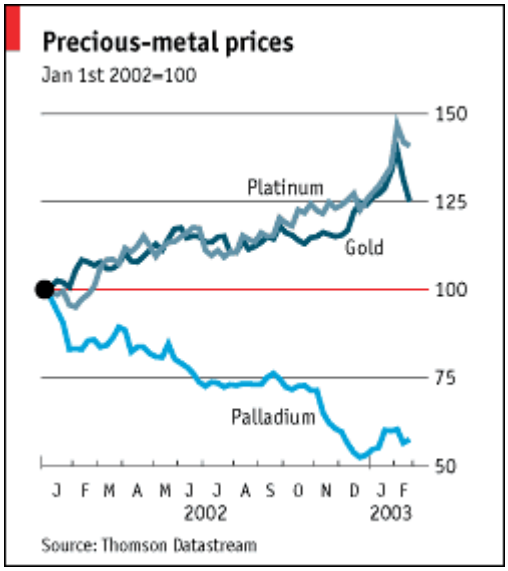
Precious-metal prices

Feb 20th 2003
From The Economist print edition

Gold has fallen by 11% from the six-year high it touched earlier this month. Platinum has also retreated, from a near 23-year high. But palladium is now 77% below its peak in January 2001.



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Overview

Feb 20th 2003
From The Economist print edition

China ran its first monthly trade deficit for six years in January, because of rising oil imports and higher oil prices. Over the past 12 months, it has notched up a hefty surplus of $26.5 billion. Chinese factories increased their output by 14.8% in the year to January.

In **Indonesia**, industrial production grew by a robust 7.1% in the 12 months to December. GDP was 3.8% higher in the fourth quarter of 2002 than a year earlier.

In **Brazil**, consumer-price inflation picked up to 14.5% in the 12 months to January. But in **South Africa**, inflation eased a little to 13.7%.

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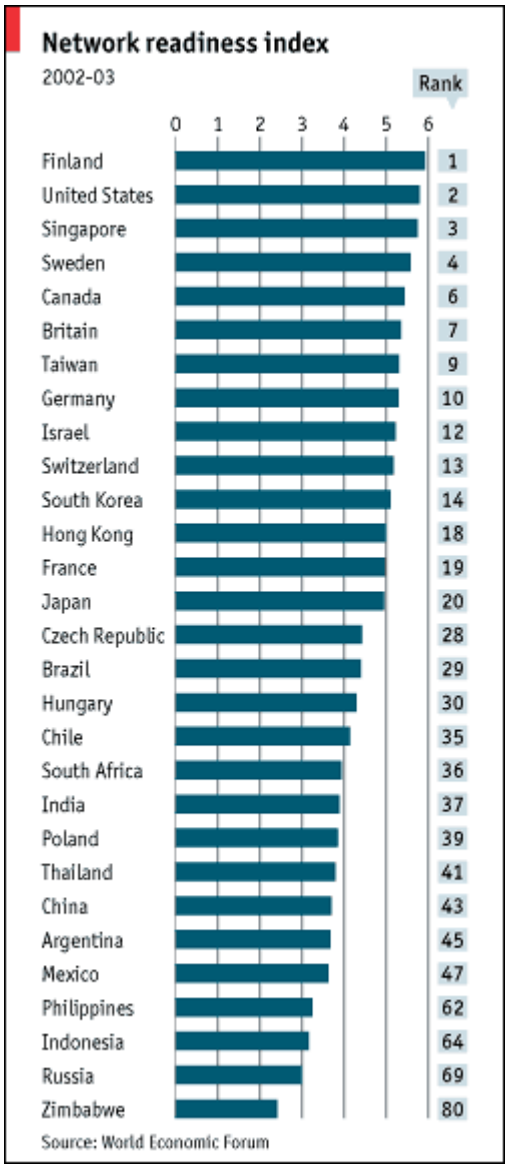
Network readiness index

Feb 20th 2003
From The Economist print edition

Finland tops the "network readiness index" compiled by the World Economic Forum in its new Global Information Technology Report. The index ranks 82 countries on market and regulatory conditions, network infrastructure, and the level of usage by individuals, businesses and governments. Finland came top because technology usage is high across the board, whereas business use dominates in the United States.



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Economy

Feb 20th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.2	Q4	+14.8	Jan	– 0.4	Dec	+26.5	Jan	+17.4	2001	269.9	Oct
Hong Kong	+ 3.3	Q3	– 7.2	Q3	– 1.5	Dec	– 7.6	Dec	+16.5	Q3	115.6	Jan
India	+ 5.8	Q3	+ 5.0	Dec	+ 3.2	Dec	– 7.3	Dec	+ 4.5	Q3	69.9	Jan
Indonesia	+ 3.8	Q4	+ 7.1	Dec‡	+ 8.7	Jan	+25.4	Dec	+ 7.5	Q3	30.5	Dec
Malaysia	+ 5.6	Q3	+ 8.0	Dec	+ 1.7	Jan	+13.4	Dec	+ 6.6	Q3	33.5	Jan
Philippines	+ 5.8	Q4	– 0.7	Nov	+ 2.7	Jan	+ 1.6	Dec	+ 6.1	Sep	13.2	Jan
Singapore	+ 2.6	Q4	+19.0	Dec	+ 0.4	Dec	+ 8.7	Dec	+18.9	Q3	84.0	Jan
South Korea	+ 5.8	Q3	+ 9.5	Dec	+ 3.8	Jan	+10.8	Jan	+ 6.5	Nov	122.8	Jan
Taiwan	+ 4.8	Q3	+10.5	Dec	+ 0.8	Jan	+16.3	Jan	+25.8	Q4	164.8	Jan
Thailand	+ 6.0	Q3	+12.0	Dec	+ 2.2	Jan	+ 4.2	Dec	+ 7.6	Dec	38.1	Dec
Argentina	–10.1	Q3	– 5.4	Nov	+39.6	Jan	+16.4	Dec	+ 7.0	Q3	10.5	Dec
Brazil	+ 2.4	Q3	+ 5.5	Dec	+14.5	Jan	+14.1	Jan	– 7.8	Dec	37.8	Dec
Chile	+ 1.8	Q3	+ 7.2	Dec	+ 3.0	Jan	+ 2.4	Dec	+ 0.9	Q3	16.4	Jan
Colombia	+ 1.9	Q3	+ 0.6	Nov	+ 7.4	Jan	nil	Nov	– 1.5	Q3	10.9	Jan
Mexico	+ 1.9	Q4	+ 1.7	Dec	+ 5.2	Jan	– 8.2	Dec	–16.1	Q3	50.6	Dec
Peru	+ 5.9	Nov	+11.7	Dec	+ 2.3	Jan	+ 0.3	Dec	– 1.0	Q3	9.1	Dec
Venezuela	– 5.5	Q3	–10.5	Oct	+33.8	Jan	+11.4	Q3	+ 7.6	Q4	9.1	Nov
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.1	Nov	– 8.0	Sep	+ 0.1	Q3	13.0	Oct
Israel	+ 1.3	Q4	– 4.0	Nov	+ 5.6	Jan	– 6.6	Jan	– 1.9	Q3	23.8	Jan
South Africa	+ 3.1	Q3	+ 1.5	Dec	+13.7	Jan	+ 3.8	Dec	nil	Q3	5.9	Dec
Turkey	+ 7.9	Q3	+13.5	Dec	+26.4	Jan	–13.6	Nov	+ 0.1	Nov	26.8	Dec
Czech Republic	+ 1.5	Q3	+ 6.6	Dec	– 0.4	Jan	– 2.4	Dec	– 4.2	Q3	24.3	Jan
Hungary	+ 3.4	Q3	+ 6.9	Dec	+ 4.7	Jan	– 3.0	Nov	– 3.3	Nov	15.3	Jan
Poland	+ 1.6	Q3	+ 4.2	Jan	+ 0.4	Jan	–10.3	Dec	– 5.7	Dec	29.3	Jan
Russia	+ 4.3	Q3	+ 4.9	Jan	+14.3	Jan	+46.2	Dec	+30.3	Q3	45.5	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	– 0.5	Jun	+ 3.4	Jan	– 1.3	Jan	+ 2.7	2002†	8.1	Dec
Saudi Arabia	+ 1.2	2001	na		– 0.9	Oct	+39.2	2001	+ 9.4	2001	20.6	Dec

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Feb 20th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 19th		Dec 31st 2001	
	Feb 19th	year ago	Feb 19th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.2	na	1,579.2	+0.0	– 7.8	– 7.8
Hong Kong	7.80	7.80	12.4	1.40	9,427.6	+1.2	– 17.3	– 17.3
India	47.7	48.6	76.0	5.72	3,302.0	+1.7	+ 1.2	+ 2.4
Indonesia	8,880	10,187	14,164	13.17	402.0	+1.6	+ 2.5	+ 20.1
Malaysia	3.80	3.80	6.06	3.10	661.0	+0.2	– 5.0	– 5.0
Philippines	54.3	51.3	86.6	8.19	1,029.3	–1.2	– 11.9	– 16.2
Singapore	1.75	1.83	2.79	0.66	1,315.5	+1.5	– 19.0	– 14.6
South Korea	1,191	1,315	1,900	4.54	600.8	+3.0	– 13.4	– 4.5
Taiwan	34.7	35.1	55.3	1.50	4,550.8	–1.6	– 18.0	– 17.2
Thailand	43.0	43.8	68.6	1.82	371.2	–2.4	+ 22.2	+ 25.6
Argentina	3.19	2.16	5.08	5.30	580.5	–0.3	+ 96.5	– 38.3
Brazil	3.61	2.43	5.76	25.34	10,251.9	–2.5	– 24.5	– 51.7
Chile	748	675	1,193	2.64	5,016.3	–0.7	– 7.1	– 17.8
Colombia	2,936	2,282	4,683	7.75	1,584.7	–2.7	+ 48.0	+ 14.8
Mexico	10.84	9.09	17.3	8.90	5,857.4	+1.6	– 8.1	– 22.3
Peru	3.48	3.47	5.55	3.93	1,534.1	+1.2	+ 30.5	+ 29.1
Venezuela	1,598	954	2,549	21.65	8,140.2	+2.6	+ 23.9	– 41.3
Egypt	5.51	4.61	8.79	8.68	6,052.2	+0.8	+ 14.8	– 4.7
Israel	4.86	4.68	7.76	6.03	316.7	+3.0	– 29.1	– 35.7
South Africa	8.3	11.4	13.3	13.60	8,570.8	–1.4	– 17.9	+ 18.3
Turkey	1,636,000	1,370,500	2,609,420	42.00	11,607.3	+5.4	– 15.8	– 25.1
Czech Republic	29.4	36.6	46.9	2.40	479.9	+0.8	+ 21.6	+ 47.1
Hungary	229	279	366	5.15	7,262.7	–2.9	+ 1.8	+ 22.1
Poland	3.87	4.18	6.17	6.32	13,844.8	+0.3	– 0.6	+ 1.5
Russia	31.6	30.9	50.4	18.00	369.2	–0.1	+ 47.0	+ 42.0
EMF (MSCI)*	1.00	1.00	1.60	na	285.4	+0.6	na	– 10.1
EMBI+†	1.00	1.00	1.60	na	236.4	+0.8	na	+ 18.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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